

THE APPLICATION OF BENEFICIAL OWNERSHIP IN ASSET-BASED SUKUK: A SHARI'AH ANALYSIS*

Mohamad Zaharuddin Zakaria
Senior Lecturer
Faculty of Syariah and Law | Universiti Sains Islam Malaysia
zaharuddin@usim.edu.my

Ahmad Zaki Salleh
Senior Lecturer
Faculty of Syariah and Law | Universiti Sains Islam Malaysia
ahmadzaki@usim.edu.my

Akhtar Zaity Abdul Aziz
Assistant Professor
Department of Fiqh and Usul al-Fiqh | International Islamic University Malaysia
akhtar@iiu.edu.my

ABSTRACT

There are two categories of sukuk namely Asset-based and Asset-backed sukuk. Asset-based sukuk is a sukuk whereby the existence of an underlying asset is sold to the investors only to facilitate the issuance of sukuk. Whereas in asset-backed sukuk, the asset is not merely used as a tool to facilitate the issuance but it is really transferred to the investor via a true sale transaction. However, in asset-based sukuk issuance, the transfer of asset to the investor is not a true sale. In simple word, only beneficial ownership is transferred to the investor while the legal title remains with the originator. The practice is seemed not to be persistent with the Shariah principle that requires the complete transfer of ownership to the buyer. In Islamic law, the ownership will determine the obligation of the owner toward his property. For example, a lessor is liable for the impairment of his property because he is the legal owner of the property while the lessee is not responsible for it because the lessee only owns the beneficial right of the property. Hence, this study is very important to determine the status of the transfer of beneficial ownership in asset-based sukuk whether it is compliant with Shariah or not? The status is vital because the result will lead to the different consequences especially with regard to the sukuk holder whether he is liable for the underlying asset or not.

Keywords: *Islamic Capital Market, Sukuk, Shariah, Muamalat.*

* The earlier version of this paper was presented at the Islamic Banking, Accounting and Finance Conference (IBAF) 2012 organized by the Faculty of Economy and Muamalat, Universiti Sains Islam Malaysia (USIM) which was held at the Faculty of Economy and Muamalat, Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai, Nilai, Negeri Sembilan, Malaysia on 2nd-3rd October, 2012.

Beneficial Ownership In Asset-Based Sukuk

1. BENEFICIAL OWNERSHIP IN ASSET-BASED *SUKUK*

Sukuk is an investment certificate that represent the ownership of the sukuk holders in proportion to their share in the underlying assets. AAOIFI defined sukuk as “*certificates of equal value representing undivided shares in ownership of tangible asset, usufructs, and services, asset of particular project or special investment activity.*”¹ Whereby according to IFSB, *sukuk* is “*certificates that represent the holder’s proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset*”² Hence, by subscribing such investment certificate, subsequently, the ownership of the underlying asset will be transferred accordingly to the subscribers. However, in the real practice especially in asset-based sukuk, only beneficial ownership is transferred to the subscribers whereby in contrast, the full ownership includes legal title and beneficial interest are transferred to them in the asset-backed sukuk.

The different type of ownership is a result of the different mode of ownership transfer in the sukuk issuance whereby in asset-backed sukuk, the transfer is done via a true sale transaction that requires the full transfer of ownership to the buyer. In contrast, in asset-based sukuk, the transfer is not a complete transfer whereby only the beneficial ownership is transfer to the subscribers while the legal title remains with the originator or the seller.

The full ownership gives the sukuk holders a full control on the underlying asset especially during the event of default since they are the legal owner of the asset. The creditors cannot claw back the asset and put it in the bankruptcy estates of the originator thus the income generated from the asset will not be affected. On the other hand, the beneficial ownership cannot prevent any action taken by the creditors to claw back the asset since the beneficial owner does not attain the legal title of the underlying asset. Hence, the sukuk holder cannot prevent such action because as a beneficial owner, he has no rights to hold the asset since he is not the legal owner according to the common law even though the sukuk holder has bought the asset through a shari’ah compliant transaction.

Some scholars did not see the practice in asset-based sukuk as Shari’ah compliant and some others claimed that the transaction is fictitious which tantamount to deception and fraud.³ It was claimed that the Shari’ah contract only used to facilitate the issuance of sukuk and in that case, the sukuk holders only entitle for the

¹ AAOIFI. *Accounting and Auditing Organization for Islamic Financial Institutions’s Shari’ah Standards*. (Bahrain: AAOIFI, 2008) <http://www.aaofi.com> (accessed on 20th July 2012).

² IFSB. *Islamic Financial Services Board (IFSB)’s Capital Adequacy Standard for Institutions (Other than Insurance Institutions) Offering Only Islamic Financial Services*. (Kuala Lumpur: IFSB, 2009) p.3 <http://www.ifsb.org/standard/ifsb7.pdf> (accessed on 5th July 2012).

³ Hussain Hamed Hassan, Comments on Discussion Papers and Notes submitted for Harvard-LSE Workshop on Sukuk, p.4. <http://www.iefpedia.com> (accessed on 12th June 2012).

beneficial ownership and not the legal ownership of the asset, even though they have bought the assets.⁴

Therefore, this study is going see whether Shari'ah allows such type of beneficial ownership as applied in the asset-based sukuk and whether the practice is really Shari'ah compliant or not. It is very important because the ruling will clarify the status of Asset-based sukuk according to the Shari'ah.

2. BENEFICIAL OWNERSHIP IN COMMON LAW

The application of beneficial ownership must be seen from both legal and Shari'ah perspectives. The practice may vary from each perspective to another. According to legal definition of beneficial ownership: "*Beneficial ownership is a beneficiary's interest in trust property.⁵ It is enjoyed by anyone who has the benefits of ownership of a Security (finance) or property, and yet does not nominally own the asset itself*"⁶ "*Beneficiary is a person for whose benefit property is held in trust; esp., one designated to benefit fro an appointment, disposition, or assignment (as in will, insurance policy, ect.) or to receive something as a result of a legal arrangement or instrument.*"⁷

While a beneficial owner is: "*Beneficial owner is one recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else; esp., one for whom property is held in trust*"⁸

Whereas beneficial interest is: "*Beneficial interest is a right or expectancy in something (such as a trust or an estate), as opposed to legal title to that thing, for example, a person with a beneficial interest in a trust receives income from the trust but does not hold legal title to the trust property.*"⁹ From the definition, it is understood that the beneficial ownership is a right of someone to use an asset or to get benefit from it even though he is not the legal owner or holding any legal title of the asset. A beneficial owner does not necessarily own the asset but he has the beneficial right or beneficial interest to enjoy the profit or benefit from the asset.

A simple example like in the case when the husband buys a house using the husband's name but at the same time the wife shares her money to pay the price. In this case, the wife is said to have a beneficial interest in the house even though the husband holds the legal title of the asset. If they get divorced, the wife has right to

⁴ Sa'fid Bouheraoua & Asyraf Wajdi Dusuki. *Taqwim Naqdi li al-Qadaya al-Shar'iyyah al-Muta'alliqah bi Milkiyyah al-Sukuk al-Qa'imah 'ala al-'Usul*, the paper presented at the conference al-Sukuk al-Islamiyyah: 'Arad wa Taqwim organized by University of King 'Abdul 'Aziz, Jeddah, 25th May 2010. p. 11-17.

⁵ Henry Campbell Black, *Black's Law Dictionary*, edited by Bryan A. Garner. (US: Thomson Reuters, 9th ed. 2009) p.1215.

⁶ The Free Dictionary. <http://encyclopedia.thefreedictionary.com> (assessed on 3rd April 2012).

⁷ Black's Law Dictionary, p.176.

⁸ Black's Law Dictionary, p. 1214

⁹ Black's Law Dictionary, p.885

Beneficial Ownership In Asset-Based Sukuk

claim part of the value of the house because she has the beneficial interest in the house due to her share in purchasing the house.¹⁰

Another example may be seen in the purchase of a car via a financial institution or bank. The bank will hold the legal title of the asset until the buyer fully pays the price while the buyer holds the beneficial right to use the car in whatever manner he wants. The bank is not responsible for any liability caused by the car or the buyer. The bank even does not bother what will happen to the car but in the case of default, the bank will possess back the car to cover any loss from the default.¹¹ That's why we have seen many traffic summonses were imposed to the beneficial owner and not to the bank because the beneficial owner is the one who has interest and control over the car. In this case, the legal title is seemed to be as a security pledged for the repayment of car loan.

Likewise, the owner of a copyright could assign some of the rights to a beneficial owner by arrangement. There are many cases in which this is done in both express and implied agreements. The copyright holder still owns the copyright, but the beneficial owner can use it like his or her own, and may make decisions involving how and where the copyright is utilized.¹²

In Malaysia, there are two types of land namely freehold and leasehold land. In a leasehold land, the owner is only be given 99 years to occupy the asset. After that, the duration either ends or be renewed for another couple of years. The government may takes over the asset after the end of the duration. This is also an example of beneficial ownership where the legal title is actually held by the government. However in this case, the beneficial owner is also attached with a title as an owner that facilitate him a full right to use the asset and even to sell it without prior permission from the legal owner.¹³

In sukuk transaction, if the asset is not fully sold to the investors, for example, only 90% of the value of the asset is sold to the investors while another 10% of the value remain with the originator, it is a also a sale of beneficial interest according to the common law whereby the investors are only given a beneficial title to represent their ownership in the asset while the legal title remains with the originator.¹⁴ This example is just like the previous example whereby the husband and wife share to buy a house but registered under the name of the husband.

The sukuk holders in asset-based sukuk only hold the beneficial ownership and

¹⁰ The Village Citizens Advice Bureau, *Beneficial Interest*, <http://www.civilpartnerships.org.uk> (accessed on 19th April 2012)

¹¹ NCHGURU, *Legal Interest versus Beneficial Interest*, <http://nchguru.blogspot.com> (accessed on 19th April 2012)

¹² S.E. Smith, *What Is Beneficial Ownership?*, <http://www.wisegeek.com> (accessed on 19th April 2012)

¹³ Wan Abdul Rahim, an interview by author at Securities Commission.

¹⁴ Zulkifli Hassan (PhD), An interview by author, 22nd May 2012 at "Universiti Sains Islam Malaysia" (USIM).

it is shown in the sukuk certificate as an evident of their share in the asset. They are only purchasing the beneficial right of the asset and not the asset itself. Beside the purchase of beneficial right, the beneficial ownership also granted to the investors who are doing a master leasing and sub leasing agreement with the originator. This is consistent with the opinion of Hanafis that the contract of Ijarah can be interpreted as a sale beneficial interest. To distinguish between the sale of beneficial right and lease of beneficial right is the latter has a fix leasing time while there is not limitation of time for the former because the sukuk holders are the owner of that beneficial right. They have absolute right over the benefits of the asset but not the asset itself. Meaning that, the sukuk holders can enjoy all benefits generated from the asset including to lease it to another party without getting permission from the legal owner of the asset. In contrast, the beneficial owner in master leasing agreement must get permission from the legal owner to sub lease the beneficial right to another party.¹⁵

The beneficial ownership may also be assigned to the sukuk holders especially in the event that the legal title of the asset cannot be changed due to certain restriction in ownership especially with regard to the native lands like the lands in Sabah, or the land in the place where the law disallows the sale of the lands to the outsiders like the lands in Kelantan and that cannot be sold except to their people. To solve this problem, the beneficial right of the asset will be assigned to the SPV. Hence, the SPV on behalf of the sukuk holders may use the beneficial right includes to lease it in order to generate incomes for the sukuk holders.¹⁶

Obviously, in order for sukuk transaction to fully function, there must be an appropriate method of transferring the proposed sukuk assets to the SPV or issuer. This raises the issue whether the asset is truly transferred to the investors or only certain right namely beneficial right is transferred to them. Indeed in asset-based sukuk, only beneficial ownership is transferred to the SPV (on behalf of sukuk holders) while the legal title is held by the originator. We know that the asset-backed sukuk applies the concept of true sale. Hence, there no issue to discuss regarding the true sale because once the transaction takes place, the investors become the legal owner of the asset. The problem is in asset-based sukuk as only beneficial ownership is transferred to them even though they have bought the asset. Before we go for Shari'ah view on that matter, it is important to disclose here the practice of how the assets are transferred to the sukuk holders. Actually, there are certain ways to transfer the asset to the sukuk holders. The beneficial ownership is also transferred via these ways. Normally, they are: [a] Sale, [b] Lease, [c] Assignment, [d] Novation, [e] Declaration of trust .

¹⁵ Nurdin Ngadimon, Assistant General Manager (Shari'ah) Islamic Capital Market Department Strategy & Development Division, an interview by author, 12th April 2012 at Securities Commission Malaysia.

¹⁶ Nurdin Ngadimon in an interview on 12th April 2012 and Wan Abdul Rahim in a phone conversation on 14th April 2012.

Beneficial Ownership In Asset-Based Sukuk

a) Sale

In the case of asset-based sukuk, the originator will sell his assets for example buildings to the investors via a trustee by way of transfer of the beneficial ownership of such assets to the trustee (on behalf of the sukuk holders). The following statement is a clause on how the beneficial right is sold to the sukuk holders in asset-based sukuk Ijarah by Telekom Malaysia: *“TM (in such capacity, the “Seller”), shall, from time to time sell certain identified Shariah-compliant leasable assets (“Ijarah Assets”) at the asset purchase price (“Asset Purchase Price”) by way of transfer of the beneficial ownership of such Ijarah Assets to the Trustee (on behalf of the Sukukholders), pursuant to the asset purchase agreement (“Asset Purchase Agreement”).”*

The clause implies that the originator sold his assets to the investors. However, it is so weird when only beneficial ownership of such assets was transferred to the trustee. If the asset was really sold to the sukuk holders, there must also involve the transfer of legal title to them. However, it was mentioned that only beneficial ownership was transferred to the trustee.

According to the common law, the legal title may be held by the seller for certain reasons. For example, the buyer does not yet fully pay the price. So, only beneficial ownership is given to the buyer. However, in sukuk transaction, the purchase price is paid in cash to the originator. Supposedly, if the investors pay the price in exchange for the asset then they should be the real owner and get the legal title of the asset but it is not that practiced in asset-based sukuk. Based on this clause, only the beneficial ownership is transferred to the trustee even though the price is fully paid. This is different from asset-backed sukuk whereby the legal title and the beneficial title both of them are transferred to the sukuk holders via a trustee in a true sale transaction.

b) Lease

The originator leases his assets to the investors by transferring the beneficial ownership to them via a trustee, immediately the trustee leases back the asset to the originator. However, it is contentious because it was claimed as a type of bay'cinah transaction.

c) Assignment

Assignment constitutes an absolute transfer of right of an asset to other party in order to allow that party to acquire the beneficial right of the asset. This normally happens if the assets in question are contractual interest. However, the assignment only transfers the beneficial right or benefit to a new owner. The obligations remain with the previous owner. This is as practiced by the English law under the section 136 of

the law of Property Act 1925.¹⁷ Assignment in Islamic law can be viewed as a contract of *Hawalah* as being used in debt transfer.¹⁸ Assignment may also be assumed as *hibah* or charity gift because the assignor has given his right to enjoy the benefit of an asset to the assignee like he gives a gift or charity to him.

d) Novation

This is a contractual means of transferring contractual rights and obligations, but this does not transfer an asset in itself. It replaces a contract with a new contract (for which consideration must be provided) with one or more new parties, and the original contract is extinguished.¹⁹ Novation in Islamic law may also be assumed as *hawalah*.²⁰

e) Declaration of trust

Under this method, no “transfer” takes place as such; a trust is declared over the assets in question in favor of the transferee.²¹ This method is applied in sukuk transaction to give a right to the trustee to hold the sukuk asset on behalf of the sukuk holders. This is important because the sukuk holders normally will be substituted by another investors especially when the former sells his notes to other. Hence, there must be a trustee who will act on behalf of the sukuk holders in order to ensure the performance of the assets will not be interrupted. In Islamic law, the obligation of the trustee in sukuk transaction can be assumed as a *wakil* or representative for the sukuk holders. According to Engku Rabiah, a Malaysian prominent law scholar whereby she mentioned that under Malaysian law, a beneficial interest is normally created as a result of a sale and purchase contract between the owner of the asset and the buyer. However, instead of getting legal title, the buyer gets only the beneficial or equitable interest because of the following reasons:

- i. There were no formal registration of transfer; or
- ii. Formal registration of transfer has not been made, normally because payment of the price has not been fully made by the buyer.²²

According to Engku Rabiah, the beneficial ownership solely transferred to the investors in asset-based sukuk transaction because the sale of the underlying asset to

¹⁷ Rahail Ali, Sukuk, Islamic Capital Market Series, *Legal Certainty for Sukuk*, p.99.

¹⁸ Frank E.Vogel, *Islamic Law and Finance: Religion, Risk and Return*, (The Hague, Kluwer Law International, 1988) p.108.

¹⁹ Rahail Ali, Sukuk, Islamic Capital Market Series, *Legal Certainty for Sukuk*, p.99

²⁰ Majid Khadduri, *Origin and Development of Islamic Law*, (New Jersey: The Lawbook Exchange, Ltd., 2010) p.374.

²¹ Ibid.

²² Eg. Rabiah Eg. Ali. *Issues in Islamic Debt Securitization*, Essential Readings In Islamic Finance, p.474.

Beneficial Ownership In Asset-Based Sukuk

them is not formally registered under the name of the sukuk holders²³ just like the wife in the first example given previously. The absence of the registration is said because of certain reasons especially with regard to the tax law. Indeed, the cost will be increasing due to the registration. According to the tax law, any income or dividends generated from the underlying sukuk assets are considered by the tax regulators as income or dividends earned from investments and not from financing, as a result, the sukuk holders will have to pay income tax. In contrast, the interest payment received from conventional bond are tax deductible.²⁴

Hence, the issuer used to choose the asset-based sukuk issuance for the sake of the investors who mostly prefer not to bear any risk from the assets. That's why the title of the assets remain with the originator. The sukuk holders prefer to hold the beneficial title for a temporary investment period rather than to bear any cost implied by the assets if they are holding the legal title of the assets.

Indeed, the issuance of asset-backed sukuk requires more quality assets in order to meet the pricing requirement. Only an asset with good quality is allowed to be facilitated in a true sale asset-backed transaction. However, there are very few companies which have such quality assets. Therefore, it is an obstacle for them to raise capital if they are compelled to get funding via asset-backed sukuk transaction.²⁵ Hence, the asset-based sukuk is probably the suitable option for them to maintain in their business and it is better than they go for the conventional interest based bond. By holding the beneficial ownership in asset-based sukuk, the sukuk holders might face with the problem of asset protection especially from the bankruptcy proceeding taken against the originator who holds the legal title of the assets. The assets will be clawed back and put into originator's bankruptcy estate and will be managed by a trustee who will organize the sale of the assets to pay the creditors.²⁶ As a result, the sukuk holders will be put on the list of the creditors as well and they have to wait the trustee to settle the debt. The situation will be getting worst if all the assets are insufficient to pay the amount due. The sukuk holders will have no option except to wait in line with other unsecured creditors to get back any balance due.²⁷ In contrast, the rights of the sukuk holders in asset-backed sukuk will not be affected because they hold the legal title and no one afterward can claim the assets since the sukuk holders are the legal owner of the assets.

²³ Eg. Rabiah Eg. Ali. *Issues in Islamic Debt Securitization*, Essential Readings In Islamic Finance, p.474.

²⁴ Nik Norzrul Thani & Madzlan, *Legal and Beneficial Ownership of the Underlying Assets in Sukuk Issuance*, 34th IIBF Discussion series on 6th January 2012, (Kuala Lumpur : Zaid Ibrahim & Co) p.12

²⁵ Nurdin Ngadimon, in an interview at Securities Commission on 12th April 2012

²⁶ Business Link, Bankruptcy: The Basics, <http://www.businesslink.gov.uk> (accessed on 20th April 2012)

²⁷ Dusuki & Mokhtar, *Critical Appraisal of Shari'ah Issues On Ownership In Asset Based Sukuk As Implemented In The Islamic Debt Market*, p. 21

Back to the transfer of beneficial ownership as mentioned in asset-based sukuk PTC issued by Telekom previously, there is a question regarding the sale of the underlying asset to the sukuk holders, if they have already purchased the assets then how can the assets be allowed to be clawed back to pay the creditors? This is weird and may contradict with the principles of Shari'ah. According to the Shari'ah, no one is allowed to trespass others property without the permission from the owner. Therefore, no one can claw back the asset if the asset is really sold to the sukuk holders except there is another meaning implied from the sale. For example, the transaction only involve the sale of beneficial interest to the sukuk holders or it is merely a fictitious contract formed to acquire the characteristic of bond but at the same time comply with the Shari'ah principles. Simply speaking, the transaction is arranged just to facilitate the issuance of sukuk to comply with *Shari'ah* rules.

In fact, it was mentioned in another asset-based sukuk's PTC that the originator sells the beneficial right/interest to the investors instead of selling the real asset itself. The status of this type of sale is quite confusing. It is rarely heard in Islamic practice that the seller only sells the beneficial interest and not the physical of the asset except in the case of Ijarah or leasing whereby the owner leases his property to the lessee. Consequently, he is said to have sold the benefit of the property to the lessee (*bay' al-manfa'ah*). However, based on the practice in the sukuk issuance, it was stated that the originator only sells the beneficial interest (manfa'ah) of a property instead of the property itself. This was admitted by a scholar in an interview whereby he agreed that the beneficial interest may be sold to facilitate the sukuk issuance.²⁸

An example that clearly mentioned the sale of beneficial interest may be seen from the Bank Negara Negotiable Note based on Ijarah concept that was issued to fatwa in 33rd meeting of SAC on 27th March 2003. There was a clause in the structure regarding the sale of beneficial interest stated that: "*Bank Negara Malaysia will sell the beneficial interests of its real property (such as land and building) to a Special Purpose Vehicle (SPV). The SPV will then lease the property to Bank Negara Malaysia for a specific period through execution of an ijarah muntahia bi al-tamlik agreement. As a consideration, Bank Negara Malaysia will pay rent (at a rate which is agreed during the conclusion of the contract) for every 6 months throughout the lease period*"²⁹

In this clause, firstly, it was shown that only beneficial interest was sold to the SPV. However, in the next sentence, the SPV was allowed to lease the property back to the previous owner namely the originator. Then what is meant by selling the beneficial interest actually? If he is allowed to execute the leasing agreement,

²⁸ Interview with Nurdin Ngadimon, Shari'ah advisor at Securities Commission Malaysia on 12th April 2012.

²⁹ SAC, Shariah Resolutions in Islamic Finance, *Issuance of Bank Negara Negotiable Notes Based on Ijarah Concept* <http://www.bnm.gov.my> (accessed on 19th May 2012)

Beneficial Ownership In Asset-Based Sukuk

meaning that he is either do that in his capacity as an owner because he has bought the asset or as a lessor because he has leased the asset from the originator by purchasing the beneficial interest. Indeed, according to Shari'ah, a lessor is allowed to sub-lease the asset. Thus, what's meant by this transaction, it is a sale of asset? or it is a leasing of asset?

In further analysis of the asset-based sukuk PTCs especially Telekom's PTC, in the maintenance clause, it was mentioned that the responsibility of the maintenance of the asset lies upon the sukuk holders although in actual practice, the originator is the man who pays the maintenance in advance after being appointed as servicing agent on behalf of the sukuk holders. The clause states that: *"Under the terms of the Servicing Agency Agreement (as defined below), TM shall be appointed as the Servicing Agent by the Trustee (on behalf of the Sukukholders) and will, amongst other things, be responsible, on behalf of the Lessor, for the performance and/or maintenance and/or structural repair of the Ijarah Assets and/or the related payment and/or ownership expenses in respect of the Ijarah Assets ("Ownership Expenses"), which are to be reimbursed by the Trustee (on behalf of the Sukukholders) to TM upon the expiry of the relevant Ijarah Agreement. The Servicing Agent shall also ensure that the takaful/insurance is for a covered/insured amount, at all times and shall be responsible for the related payment of the relevant takaful contribution or insurance premium."*

If all these ownership expenses are obligatory for the sukuk holders, meaning that they are the real owner of the underlying assets. Therefore, although the previous clause stated that only beneficial ownership was transferred to the sukuk holders but they were actually purchasing the assets as evidenced by their obligation to maintain the assets. According to Islamic law, such obligation lies on the owner (lessor) and not the lessee.³⁰ So, the beneficial ownership here actually represents the ownership of the sukuk holders in the value of the assets which is recognized by the common law as a beneficial interest of the asset regardless of the legal title that remains with the originator. However, Islamic law does not recognize this concept of beneficial ownership. The sukuk holders are the legal owner of the assets even though the legal title remains with the originator because the sukuk holders have bought the assets according to the term sale stated in the clause.

It should be noted that in common law, the legal title is crucial to determine the owner of an asset. According to the law, the legal owner is the one who holds the legal title,³¹ meaning that, even though the sukuk holders have bought the assets but according to the common law, the originator is the owner of the asset. The beneficial

³⁰ Al-Kasani, Abu Bakr bin Mas'ud, *Bada'ir al-Sana'ic*, (Beirut: Dar al-Kutub al-'Ilmiyyah, 2nd ed. 1986), vol.4, p.208

³¹ Zulkifli Hassan (PhD), An interview organized on 22nd May 2012 at "Universiti Sains Islam Malaysia" (USIM).

owner only owns the benefit of the asset and not the body of the asset. That is why if the originator got bankrupt, the asset will be clawed back and put in the bankruptcy estates even though it was sold to the sukuk holders.

According to a view from an expert³², the sale of beneficial interest as mentioned in the clause and as practiced in asset-based sukuk is actually a leasing agreement whereby the originator only leased his asset to the SPV and subsequently the SPV leased back the asset to the originator. The sale of beneficial interest in the clause is equal to *bay' al-manfa'ah* in Ijarah contract and it is consistent with the definition of *Ijarah* by Hanafis scholars whereby they defined Ijarah as a sale of benefit or *manfa'ah*.³³

This view is also consistent with the case of Nakheel sukuk that revealed the problem of selling the beneficial interest to the sukuk holders. In this case, the originator sold the assets which was a leasehold rights to the underlying tangible assets for a period of 50 years to the SPV.³⁴ Then the SPV leases back the assets to the originator. Even though, the contract mentioned the sale of assets to the trustee but it was actually a sale of leasehold rights and not the real assets. However, the law of Dubai did not recognize the beneficial interest as a real rights or property rights. Therefore, the transfer of beneficial ownership of a leasehold rights via a sale and purchase agreement was not considered as a sale according to the law. However, it was merely a lease agreement which is equal to the lease and leaseback transaction in the English law. Such agreement only viewed as a personal contractual rights and there was no transfer of ownership actually according to the law. Hence, the sukuk holders were not considered as the owners of the underlying assets. In the event of default whereby the originator was unable to make payment due to bankruptcy, the assets were clawed back and put in the bankruptcy estates of the originator and the sukuk holders were put in the list of the creditors.³⁵

In this case, even though the term and agreement said that the originator sold the sukuk asset to the issuer which is a leasehold right but the law said it was merely a leasing agreement because a sale of leasehold rights is only equal to *Ijarah* and not a real sale.

However, this view still can be argued in the sense that the clause mentioned the sale has taken place between the originator and the SPV. As a proof, the second agreement namely *al-Ijarah al-muntahiyah bi al-tamlik* has been executed. The contract implies that the SPV will sell back the leased asset to the originator at the

³² Wan Rahim, ICM Director, in a phone conversation on 12th May 2012.

³³ Al-Marghinani, 'Ali bin Abi Bakr, *Al-Hidayah fi Sharh Bidayah al-Mubtadi*, (Beirut: Dar Ihya' al-Turath al-'Arabi, n.d) vol.3, p.230.

³⁴ Nakheel Principal Terms and Conditions (PTC), p.8, <http://blogs.thenational.ae> (accessed on 28th May 2012).

³⁵ Omar Salah, *Dubai Debt Crisis: A Legal Analysis of the Nakheel Sukuk*, Berkeley Journal of International Law PUBLICIST, p.30. <http://bjil.typepad.com> (accessed on 20th July 2011).

Beneficial Ownership In Asset-Based Sukuk

end of the leased period. The SPV may not sell the asset if the entity does not own the asset at the first place. Furthermore, as mentioned previously, all the ownership expenses are the obligatory of the sukuk holders. Hence, this may implies that the SPV in the first agreement was really buy the asset but for certain reason, the legal title remains with the originator and only beneficial ownership was transferred to the trustee.

Finally, since the transactions in asset-based *sukuk* only involve the transfer of the beneficial ownership to the sukuk holders, it could be possible that only beneficial interest is sold to them as recognized by the common law. If it is true, then we have to determine whether it is permissible according to Shari'ah to sell the beneficial interest alone whereby the body of the asset remains with the seller (original owner).

3. BENEFICIAL INTEREST IN ISLAMIC LAW

Manfa'ah or benefit literally is derived from its root word (نفع) which means good.³⁶ Whereas *manfa'ah* itself means something that contain good, usefulness and benefit.³⁷ From the Shari'ah point of view, the meaning of beneficial right or beneficial ownership generally could be linked to the meaning of *haqq al-intifa'* and *milk al-manfa'ah*. *Haqq al-intifa'* has been defined as the right of someone to use a property whereby he may utilize it in order to get benefit from it as long as the property maintained in good condition as before he use the propety.³⁸

In another definition, *haqq al-intifa'* has been defined as a special right bestowed to the beneficial owner whereby the right will end upon his death. This special right may be concluded among the living human being such as in leasing (*ijarah*) or lending (*i'arah*) and among the living and death people whereby the right is granted to certain person but it will be only executed after the death of the benefactor such as in the will (*wasiyyah*) and endowment (*waqf*).³⁹

According to Hanafis, *haqq al-intifa'* and *milk al-manfa'ah* are the same thing. Thus, those who are holding the beneficial right may use the property for his own and allow others to use the property as well.⁴⁰ However, Maliki distinguished *haqq al-intifa'* from *milk al-manfa'ah* whereby *haqq al-intifa'* is defined as a license or permission to use a property only for personal use and he is not allowed to permit others to use it as well. In contrast, *milk al-manfa'ah* is the right of the beneficial owner to use the benefit personally or to give permission to others to use it includes

³⁶ Mustafa and friends, *al-Mu'jam al-Wasit*, (Dar al-Da'wah, n.d) vol.2, p.942.

³⁷ Ahmad Mukhtar, *Mu'jam al-Lughah al-'Arabiyyah al-Mu'asarah*, (Saudi Arabia: 'Alam al-Kutub, 2008) vol.3, p.2259.

³⁸ Sanu, Qutub Mustafa, *al-Muddakharat Ahkamuha wa turuq Takwiniha wa Istithmaraha fi al-Fiqh al-Islami*, (Beirut: Dar al-Nafa'is, 2001) p.97.

³⁹ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, (Damascus: Dar al-Fikr, 4th ed. 1997) vol.6, p.443.

⁴⁰ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.6, p.443.

making it as a subject matter in the contract of exchange such as leasing or as a subject of loan in a loan contract.⁴¹ This way of different is very important for Malikis in order to determine certain rulings in their Mazhab.⁴² Al-Suyuti a Shafi'i scholar also shared the same idea that the right of *intifa'* is different from the right of *manfa'ah* whereby he mentioned that the meaning of the right of *intifa'* is a right to use a property but without the benefit of that property such as a borrower who has the right to use the borrowed item for his own but he is not allowed to lease the item to others in order to get benefit from it.⁴³

From the definition, it may be understood that the beneficial right in Islamic law is only a temporary right for a beneficial owner to use it during the duration allowed by the owner of the property (*'Ayn*). The jurists always used the examples like leasing, lending, *wasiyyah* and *waqf* to show the execution of the transfer of beneficial right to a certain party. The transfer may be done via a contract of exchange like leasing or via a charity or *tabbarru'* like *wasiyyah* and *waqf* whereby there is no return for the transfer.

In Islamic law, basically, there are two types of ownership either complete ownership or partial ownership. A complete ownership or *al-milk al-tam* confers its owner a full right over his property includes control and benefit. On the other hand, a partial ownership only confers its owner either only the control of the property or only benefit of the property. It is known as *al-milk al-naqis*.⁴⁴

Previously, it was mentioned the ways to obtain the complete ownership of a property. With regard to the beneficial ownership, it is considered as a partial ownership in Islamic law. When someone is only given a right to use a property, he is said to have a partial ownership of that property. It is same to the owner of that property whereby at the time he gives the right to use his property to another person subsequently he has no more right to use his asset but he still have the right of control over his asset. In this situation, the owner is temporarily hold the partial ownership of the property until he get his property back to him then he will gain his complete ownership over his property again.

The partial ownership in Islamic law is divided into three categories:⁴⁵

- a) The right of control and supervision only (*raqabah*) of the property (*milk al-'ayn*)

⁴¹ Al-Qarafi, Ahmad bin Idris, *Anwar al-Buruq fi Anwa' al-Furuq*, (Saudi Arabia: 'Alam al-Kutub, n.d) vol.1 p.193.

⁴² For example, a husband cannot allow others to benefit from his wife because the contract of marriage only gives him the right of *intifa'* and not the right of *manfa'ah* so he is allowed to get benefit from his wife for his own only. It should be noted that this methodology might apply only in Malikis mazhab.

⁴³ Al-Suyuti, 'Abd. Rahman bin Abi Bakr, *Al-Ashbah wa al-Nazair*, (Beirut: Dar al-Kutub al-Ilmiyyah, 1990) p.326.

⁴⁴ Al-Zuhayli, Wahbah, *Al-Fiqh al-Islami Wa Adillatu*, vol.4, p.415.

⁴⁵ *Ibid.* vol.4, p.415-419.

Beneficial Owneship In Asset-Based Sukuk

- b) The beneficial right only (*haqq al-intifa^c or milk al-manfa^cah al-shakhsi*)
- c) Beneficial right only (*Milk al-manfa^cah al-^caini or haqq al-irtifaq*)
 - a. The right of supervision only (*milk al-^cayn*)

In this category, the owner only owns the corps (*ayn*) while another person owns the benefit. This can be achieved by the way of wills for instance, let say a person A states in his will regarding his house that he will give it to the person B to occupy that particular house for his entire life or for a certain period like three years. Meaning that, the beneficial owner will have only the right to occupy the house while the person A remains as the owner of the house. The right to occupy the house will end upon the death of the beneficial owner or upon the end of the stated period. After that, the beneficial right will go back the A's ancestors and they regain the complete ownership again. In this case, the owner of the property is not allowed to use the property or to enjoy any benefit from the property. It becomes compulsory for the owner to submit the property to the beneficial owner and in the event that the owner (ancestor) disobeys the will, a further action may be taken against him.⁴⁶

Milk al-ayn may be considered as a legal ownership in Islamic law. Those who hold the ownership will also hold the legal title of the property. The legal owner is the real owner according to Islamic law. However, according to the common law, those who hold the legal title does not necessarily own the property. For instance, a trustee may holds the legal title on behalf of the real owner. Sometimes, we buy a piece of land without changing the legal title of the land. Consequently, the legal title remains under the name of the previous owner but the land is ours. Instead of legal title, we are given with the beneficial title to evident our ownership in that property. Indeed, this practice is allowed in the common law. But in Islamic law, the separation between the legal title and beneficial title is different from the common law. The legal title implies that the holder is the real owner of certain property except there are another evidences prove vise versa. On the hand, if someone holds the beneficial title, he is the one who rents the property. It is implied that the beneficial ownership only given to the lessee and not to the owner. In contrast, the beneficial ownership may be given to the real owner in certain situations according to the common law.

- b. Beneficial right only (*haqq al-intifa^c or milk al-manfa^cah*)

The person B in the previous example is said to be as a beneficial owner of the property because he only hold the beneficial right of the property or he only owns the benefit of the property and not the property itself. Meaning that, he is only allowed to enjoy the benefit of the property but he cannot sell the property because he is not the owner of the property.

⁴⁶ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.415.

The beneficial right in Islamic law may be obtained via certain ways or contracts. There are five ways to acquire the beneficial right of a property namely: ⁴⁷ [i] Loan (*I'arah*), [ii] Leasing (*Ijarah*), [iii] Endowment (*Waqf*), [iv] Wills (*Wasiyyah*), [v] Allowance (*Ibahah*).

According to the majority of Hanafis⁴⁸ and Malikis⁴⁹, loan is giving away the beneficial rights without exchange (تمليك المنفعة). A borrower may use the property for his own and may lend it to others.⁵⁰ However he is not allowed to lease it because according to them, a loan contract is a contract of (*Ghair lazim*) that may be retrieved at any time upon the call of the lender. In contrast, leasing is a contract of (*lazim*) and it is greater than a lending contract, thus it is not comparable with the contract of lease. Furthermore, the leasing of the borrowed property to others may cause harm to the owner.⁵¹

According to Shaficis⁵² and Hanbalis⁵³, a loan is a contract whereby the lender gives permission to acquire the benefit of a property (أباحة المنفعة) without any return from the borrower. Therefore, the borrower is not allowed to lend it to another person. Here, the intention of the lender will determine the rights of the borrower upon the property whether it is giving ownership (تمليك) of the benefit or just only giving permission (أباحة) to use the benefit. If it is *tamlík* then the lender will have full right on the benefit include to lend it to others but if it is *ibahah* then the borrower has no right to lend it to others.

In the case of leasing or *Ijarah*, the beneficial interest or benefit of a property is transferred to the lessor who -according to Hanafis⁵⁴- has purchased the benefit of that property. In return, the owner must allows the lessor to use the property and subsequently the owner has no more right to use his property until the end of the lease period.

In a leasing contract, the benefit is exchanged for something (تمليك المنفعة). Meaning that, the benefit is sold to the lessee. Thus, the beneficial owner that is the lessee may use the benefit for his personal use or he may leases it with another rental price or he may also gives it to another person for free because he is the owner of the benefit. However if the benefit is different from the benefit obtained from the leasing then the lessee must firstly get permission from the owner to lease it to another party.

⁴⁷ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.415-417.

⁴⁸ Al-Kasani, *Bada'ir Sana'ir*, vol. 6, p.212.

⁴⁹ Al-Dusuqi, *Hashiah al-Dusuqi 'ala al-Sharh al-Kabir*, vol.3, p.435.

⁵⁰ Abu al-Ma'ali, Mahmud bin Ahmad, *al-Muhit al-Burhani, fi al-Fiqhi al-Nu'mani*, (Beirut: Dar al-Kutub al-'Imiyah, 2004) vol.5, p.556.

⁵¹ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.415.

⁵² Al-Nawawi, Yahya bin Sharaf, *Al-Majmu' Sharh al-Muhazzab*, (Beirut: Dar al-Fikr, n.d), vol.14, p.209.

⁵³ Ibn Qudamah, 'Abdurrahman bin Muhammad, *al-Sharh al-Kabir 'ala Matni al-Muqni'*, (Beirut: Dar al-Kitab al-'Arabi, n.d) vol.5, p.368.

⁵⁴ Al-Kasani, *Bada'ir al-Sana'ir*, vol.4, p.174.

Beneficial Ownship In Asset-Based Sukuk

55

In an endowment, a property is refrained from any possession by others. The beneficial right of the property is only given to the subject of the endowment or beneficiary who has been determined by the owner or benefactor. The beneficiary may use the property for his own and he may allow others to use it as well but with the permission of the benefactor.⁵⁶ The majority of jurists include Hanafis, Shafi'is and Hanbalis said that the benefit of the said property will be refrained permanently as an endowment property,⁵⁷ while Malikis allowed the owner of a property to give his property for the purpose of endowment for temporary period.⁵⁸

In a will testament, like endowment, only beneficial right is conferred to certain party in order for that party to use it whereby he may also transfer the right to another party as well either with price or without price but with the permission of the owner in order to execute the transfer.⁵⁹

Last but not least, in allowance testament, the owner only gives a permission to certain party to use his property or even to consume it. For example, a permission from someone to eat his foods and drinks, a general permission to use the public facilities or a special permission to enter into certain restricted department like hospital and universities. Hence, this special rights may not be transferred to another party without the permission of the owner.⁶⁰

From this type of rights namely *haqq al-intifa'*, it is implied that Shari'ah allows the transfer of beneficial ownership include to sell the rights to another party whereby the legal owner may not be allowed to use the asset. For example, in leasing, the beneficial rights has been sold to the lessee so the legal owner of the asset may not use the asset until the lease period ends. Similar to endowment and will testament whereby only the benefit of an asset is transferred to the subject party while the legal title remain with the original owner ever though he may not allowed to use the asset anymore.

Finally, the jurists had distinguished between the concept of possession (تمليك) and the concept of allowance (إباحة) whereby in possession, the owner of the beneficial rights may use the rights freely include to dispose it as long it is free from any restriction. While in allowance or *ibahah*, it is merely a permission to use certain

⁵⁵ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.416.

⁵⁶ *Ibid*

⁵⁷ Ibn 'Abidin, Muhammad Amin bin 'Umar, *Hashiah radd al-mukhtar 'Ala al-durr al-mukhtar*, (Beirut: Dar al-Fikr, 2nd ed., 1992), vol.3, p.506, Al-Sharbini, Muhammad bin Ahmad, *Mughni al-Muhtaj*, (Beirut: Dar al-Kutub al-'Ilmiyyah, 1994), vol.2, p.383, Al-Buhuti, Mansur bin Yunus, *Kasshaf al-Qina' 'An Matni al-Iqna'*, (Beirut: Dar al-Kutub al-'Ilmiyyah, n.d), vol.4, p.250.

⁵⁸ Al-Dusuki, Muhammad bin Ahmad, *Hashiah al-Dusuki 'Ala Sharh al-Kabir*, (Beirut: Dar al-Fikr, n.d), vol.4, p.79.

⁵⁹ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.416.

⁶⁰ *Ibid*. vol.4, p.417.

matter and no disposal is allowed.⁶¹ in this case, the permission of the legal owner is required for all purposes that are not stated by the owner.

c. The right of utilization or easement right (*Haqq al-Irtifaq*)

The right of utilization or easement right is a right to derive benefits from the immovable property of someone else. Easement right (*Haqq al Irtifaq*) has been defined by Abu Zahrah (1939) as “The right of the different benefit of one property over the other, regardless of the owner. This right has been recognized by the shariah in the spirit of generosity which members of a community should display about each other. Following are important classes of this right: ⁶²

- i. The right to obtain drinking water for self and animals from the canal privately owned by someone else, known as *haqq al-shurb*.
- ii. The right to fetch canal water from across the land owned by someone else, known as *haqq al-majra*.
- iii. The right to drain out waste water over the property of someone else, known as *haqq al-masil*.
- iv. The right of access to one’s own property across the property of someone else, known as *haqq al-murur*.
- v. The right of stopping the neighbor from carrying out such modifications in his property that may cause harm to oneself, known as neighboring rights (*haqq al-jiwar*). There two types of *haqq al-jiwar* namely vertical (*ta’alli*) and horizontal (*Janibi*).

Regarding the easement rights, there was a discussion among the jurists that the benefit from the easement rights may be sold because they are considered as permanent right to its owner even the owner of the property changes.

4. SALE OF BENEFITS

In the next discussion, we will see whether Shari’ah allows the sale of benefit or not? And whether the permissibility of selling the easement right can be extended to the sale of beneficial interest in other type of properties or not in the sense that the easement right is also a type of usufruct or beneficial interest of a property.

According to the definition of sale by the jurists in all four *mazhab*, only Shafi’is and Hanbalis accepted that beneficial interest or *manfa’ah* is permitted to be sold. The reason of the difference in their opinion is because their interpretation of *manfa’ah* whether it is a type of property (*mal*) or not. Those who considered it as property, they allowed the sale of *manfa’ah* but for those who did not consider *manfa’ah* as *mal*, they did not allow the sale of *manfa’ah*.

⁶¹ Al-Zuhayli, Wahbah, *Al-Fiqhu al-Islami Wa Adillatu*, vol.4, p.417.

⁶² <http://www.w.islamicport.com> (accessed on 14th May 2012).

Beneficial Ownership In Asset-Based Sukuk

According to Shafi'i's definition of sale, it was determined by the definition by the jurists that: "sale is a contract that consist of an exchange of property (*mal*) with property (*mal*) in to gain the ownership of the corps (*'Ayn*) or permanent beneficial interest (*manfa'ah mu'abbadah*)"⁶³ Here, *manfa'ah* is considered as *mal* since it is allowed to be exchanged for another *mal*. Indeed, *manfa'ah* or benefit of house or person (service) are permitted to be as dowry in the contract of marriage.⁶⁴ It is implied that *manfa'ah* or benefit is also a property (*mal*) because only *mal* can be taken as dowry according to Islamic law.⁶⁵

Al-Sharwani defined the word permanent with an example such as "the the right of access to one's own property across the property of someone else or *haqq al-murur* if the contract is concluded in the contract of sale"⁶⁶ According to this interpretation, it is clearly defined that the beneficial interest or beneficial right may be sold separately from the property. This is understood from the example that the right of passage which is a type of beneficial right that linked to certain land may be sold in a sale contract. Hence, another beneficial rights such as leasehold right or financial rights⁶⁷ should be allowed as well to be sold separately from a property. These rights are also linked to the land –if the said property is a land- and it is sold permanently to the sukuk holders. Thus, it is qualified to be as a subject matter in the contract of sale.

Al-Sharbini defined sale as "a financial exchange contract that resulting in possession of the permanent ownership of a property (*milk 'ayn*) or benefit (*manfa'ah*), includes the sale of the right to pass across other's property and likewise, but exclude the contract of leasing that tied-up with time because it is not sale".⁶⁸ Ibnu al-Qasim al-Ghazzi said: "sale is a contract to possess the ownership of a financial property in return for an exchange permitted by Shari'ah or a possession of a lawful beneficial interest (*manfa'ah mubahah*) permanently for a certain price...the beneficial interest includes the possession of the right of construction."⁶⁹

Then al-Bajuri further elaborated the beneficial interest may includes the rights of way (*haqq al-murur*) and the right to place woods on top of the wall and the example of the sale of *manfa'ah*: "I sell to you the rights to build on the top of this building"⁷⁰

⁶³ Ibnu Hajar al-Haytami, Ahmad bin Muhammad, *Tuhfatu al-Muhtaj fi Sharh al-Minhaj*, (Egypt: Maktabah al-Tijariyyah al-Kubra, 1983) vol.4 p.215.

⁶⁴ Al-Subki, 'Abdul Wahhab bin Taqiyuddin, *al-Ashbah wa al-Nazair*, (Beirut: Dar al-Kutub al-Imiyyah, 1991) vol.2 p.278.

⁶⁵ Al-Zuhayli, Wahbah, *al-Fiqh al-Islami wa Adillatuhu*, vol. 9 p.245.

⁶⁶ Ibnu Hajar al-Haytami, *Tuhfatu al-Muhtaj fi Sharh al-Minhaj*, vol.4 p.215.

⁶⁷ Financial right such as the right to receive rental payment or Ijarah receivables.

⁶⁸ Al-Sharbini, *Mughni al-Muhtaj*, vol.2, p.3.

⁶⁹ Al-Bajuri, Ibrahim, *Hashiah al-Bajuri 'ala Sharh al-Ghazzi 'ala Matni Abi Shuja'*, (Bulaq, Egypt: Matba'ah al-Amiriyyah, 5th ed., n.d) vol.1 p.340.

⁷⁰ Ibid.

Finally, al-Shatiri concluded that: “a sale literally means an exchange of something for something else, and sale in Shari‘ah perspective is a financial exchange contract that resulting in permanent possession of the ownership of a property or *manfa‘ah* of a property such as the sale of the rights of way, the rights to place woods on top of the wall and the rights to build on the top of the roof”.⁷¹

From the description of the jurists regarding the sale of beneficial interest (*manfa‘ah*), it could be concluded the sale of beneficial interest may be allowed with conditions as follow:

- a. The benefit or usufruct must be lawful
- b. The benefit must have value
- c. The ownership of the beneficial interest pursuant to the sale must be permanent.
- d. The contract must be in the form of sale contract or sale term.
- e. The benefits are linked to a property

Therefore, other types of benefits such as the lease hold right or the right to receive the payment of rentals and other benefits generated from a property should be allowed as well if they are sold permanently in a contract of sale. Furthermore, all of these rights are generated from a property similar to the examples given by the jurist.

The jurists had given the easement rights as examples of benefit permitted to be sold in a contract of exchange. This type of rights is indeed related to public interest needs which is originally may be used by public for free. Eventhough, the jurists still allowed to get profit from these rights by selling them to the needs because these rights are also properties (*mal*) and they are actually linked to the individual properties such as lands and buildings. Hence, it is more preferable to allow the sale of other benefits as well because the rights to receive rentals for example are more profitable in term of value. Furthermore, in order to safeguard the property, it is obligotary to generate more profit from a property by selling its benefit to the needs. This is also meant to safeguard one of the objectives of Shari‘ah that is to safeguard property (*mal*). Keeping a property without any action to expand it is actually a waste and it will destroy the property either sooner or later.

Finally, the jurists also mentioned the difference between the sale of beneficial interest and the sale of *manfa‘ah* in leasing contract whereby there is no limitation of time in the contract of sale in the sense that the owner will permanently own the benefit whereas in leasing there is a limitation of time whereby the owner only own the benefit for temporary time.

The similar opinion saying that the benefits generated from a property may be sold also came from Hanbalis school of thought. It is understood from the definition of sale given by their jurists whereby they defined sale as: “an exchange of financial

⁷¹ Al-Shatiri, Muhammad bin Ahmad, *Al-Yaqut al-Nafis fi Mazhab Ibni Idris*, (Jeddah: ‘Alam Ma‘rifah, 4th ed., 1981) p.74.

Beneficial Ownership In Asset-Based Sukuk

*property...or lawful beneficial interest in absolute manner such as the right of passage...*⁷². Al-Mardawi defined briefly that: “*a sale is possession of the ownership of financial property or lawful benefit of a property permanently in return for its price*”⁷³

Similar to Shafi‘is, Hanbalis who also considered benefit of a property as also a property (*mal*), hence they allowed the sale of benefit as long as it is lawful and sold for permanent ownership.

The second group that consists of Malikis and Hanafis clearly mentioned in their definition of sale that benefit could not be sold. Malikis mentioned this in one of the definition of sale by their prominent scholar Ibnu ‘Arafah whereby he defined sale as: “*a contract of exchange of properties exclude usufruct*”⁷⁴.

The definition implies that only real property or *‘ayn* is allowed to be the subject matter in the sale contract. Whereas usufruct is not eligible because it is not property. Whereas in Hanafis school, sale is defined as: “*an exchange of property with property*”⁷⁵

Even though the sale according to them is an exchange of property with property but the benefit or *manfa‘ah* according to them is not a property or *mal* because according to them, *mal* is a real property and what is not real such as benefit or usufruct are not considered as property or *mal*.⁷⁶

Based on the opinions of the jurists regarding the sale of beneficial interest (*manfa‘ah*), the researcher is in the opinion that the usufruct should be allowed to be sold separately from an asset. This is based on the view of the Shafi‘is and Hanbalis that allowed the sale of *manfa‘ah* based on their argument that *manfa‘ah* is also a property (*mal*). Thus, it may be sold like the tangible asset as well as being applied in the sale of the easement rights. Furthermore, the sale of usufruct is very crucial nowadays especially in the asset-based sukuk transaction that involves the sale of beneficial interest (beneficial right, beneficial title, beneficial ownership) to the sukuk holders. If it is not permissible, the Islamic economic will not develop and may turn into a deadlock situation. Investors especially Muslims will go for *riba*-based bonds. Hence, for the sake of the Islamic economic system and for the interest of the Muslims investors, the sale of beneficial interest in asset-based sukuk should be allowed.

⁷² Al-Buhuti, *Kasshaf al-Qina‘*, vol.3 p.135.

⁷³ Al-Mawardi, ‘Ali bin Sulayman, *al-Insaf fi Ma‘rifah al-Rajih mina al-Khilaf*. (Beirut: Dar Ihya’ al-Turath al-‘Arabi, n.d), vol.4, p.260.

⁷⁴ Al-Dardir, *al-Dusuki ‘ala Sharh al-Kabir*, vol.3 p.2.

⁷⁵ Ibn Nujaym, Zaynuddin bin Ibrahim, *Al-Bahr al-Ra‘iq Sharh Kanz al-Daqa‘iq*, (n.p: Dar al-Kitab al-Islami, n.d), vol.5, 256.

⁷⁶ Al-Hasfaki, Muhammad bin ‘Ali, *Al-Durr al-Muntaqa bi Hamish Majma‘ al-Anhar*, (n.p, n.d) vol.2 p.3.

5. CONCLUSION

Beneficial interest and *manfa'ah* are two terms which literally means benefit. However in term of practice, there are some differences that distinguish between the two. Beneficial ownership that represents the right of the beneficiary i.e the owner of the benefit in common law is different from the beneficial ownership in Islamic law. There are slightly different in term of the application of the term in common law and Islamic law. According to the common law, we are allowed to buy an asset without transferring the legal title to the buyer instead the buyer is given the beneficial ownership to represent his rights in the assets. This is called "Off-balance sheet" transaction whereby the asset still remain in the balance sheet of the seller. In this case, the buyer is the owner of the asset even though the seller holds the legal title.

This application of beneficial ownership however is different from the beneficial ownership in Islamic law. According to Islamic law, when someone buys a property, subsequently he will become the legal owner of the property. If there is an official legal title then it must be transferred immediately to avoid any misunderstanding in the future regarding the ownership of the property. There is no such transfer of beneficial ownership to the legal owner in Islamic law merely to represent the rights of the owner in the asset like what has been practiced in the common law. Even though the common law gives him a beneficial ownership but it is not sufficient according to Islamic law because the buyer is not a beneficial owner but he is the legal and real owner indeed. However, the practice of giving the beneficial ownership does not make the contract invalid. In fact, the contract is valid based on the fact that both parties have given their consent and agreed with the terms and conditions. The prophet said: *Indeed the sale is by mutual consent* (*إِنَّمَا الْبَيْعُ عَنْ تَرَاضٍ*⁷⁷)

Therefore, the sale and purchase agreement concluded between the originator and the issuer in asset-based sukuk is valid and legal. The consent of the issuer on behalf of the sukuk holders to accept the sale gives the absolute rights of ownership in the asset to the sukuk holders. Meaning that, they are the real owner of the asset even though the legal title remains with the seller (originator). Thus, in the event of default, no one should be allowed to take back the asset and put in the bankruptcy estates of the originator because the asset is belonged to the sukuk holders and not the originator even though the legal title is held by the originator. It is unlawful to trespass other's property.

Therefore, in order to avoid any dispute in the future, it is advised to completely transfer the legal and beneficial ownership to the sukuk holders as being practiced in asset-backed sukuk. However, the practice of giving beneficial ownership to the

⁷⁷ Ibnu Majah, Muhammad bin Yazid, *Sunan Ibn Majah*, (Beirut: Dar Ihya' al-Kutub al-^cArabiyyah, n.d) vol.2, p.737.

Beneficial Ownership In Asset-Based Sukuk

sukuk holders in asset-based sukuk is not contrary to the Shari'ah principles. It does not oppose the objective of the contract because the sukuk holders are still being considered as the owner of the assets even though the legal title remain with the originator. It is only a matter of a formal registration which does not affect the legality of the contract. The authority has taken this measure in order to protect the interest (*maslahah*) of the investors and the asset as well. When there is *maslahah* in practicing certain matter, Shari'ah does allows the practice as long as the matter does not contrary with any of the Shari'ah principles. In fact, Shari'ah recognized every decision taken by the authority for the sake of *maslahah* of the public.

Regarding the issue of "claw back" of the asset by the creditors, this is contrary to the objective of sale in Islamic law unless the object has been taken as a pledge in that transaction. However, it must be understood that the underlying asset is belong to the sukuk holders. Only the legal title remains with the originator whereby in the real situation, the assets was sold to the sukuk holders. Thus, it is not allowed to seize the assets because the sukuk holders are not the insolvent parties. This happen because the legal title of the asset remains on the balance sheet of the originator even though they were sold in order to facilitate the sukuk issuance. In the event that the originator is declared insolvent, every assets which its legal title remain with the originator will be put in the bankruptcy estates of the insolvent party.

This issue has been handled by adopting the purchase undertaking in the clause. It is mentioned in the PTC that the originator will repurchase the underlying asset upon the maturity date or upon the occurrence of dissolution events include the insolvency of the issuer. The following clause describes the effect of the dissolution event: *"Upon the occurrence of a Dissolution Event, the Trustee may, at its sole and absolute discretion and shall, if so directed by an extraordinary resolution of the Sukukholders or upon occurrence of the event mentioned in paragraph (xvi) above (relating to a Total Loss Event), shall (subject to its rights to be indemnified to its satisfaction against all costs and expenses thereby occasioned), declare (by giving notice to the Issuer) that a Dissolution Event has occurred and the Trustee is entitled to enforce its rights under the Transaction Documents, including, if applicable, requiring the Obligor to purchase the Ijarah Assets and pay the Exercise Price under the Purchase"*⁷⁸

As a result, the originator will pay the sukuk holders by executing the purchase undertaking so that the sukuk holders will be protected from the insolvency of the originator. Thus, we may say that the asset which has been clawed back is belong to the originator indeed because he has purchased back the asset.

If the sale is interpreted as a sale of beneficial interest alone, it is also unusual in the context of Islamic law practice. Nevertheless, it is not far from the sale of *manfa'ah* in Islamic law whereby Hanafis scholars defined Ijarah as a sale of

⁷⁸ Sukuk Ijarah Telekom-PTC, p.17.

manfa'ah. Besides, Shafi'is and Hanbalis recognized the sale of benefit in their definition of sale. Indeed, they allowed to sell the easement rights such as the air space and the rights of passage. Furthermore, beneficial interest also a form of property (mal). Thus, the sale of other beneficial interest should be allowed as well. However, it should be concerned that if the sale of beneficial interest is based on certain duration or period, it is considered as leasing and not sale anymore. Hence, if the agreement is concluded under the term sale, no limitation of ownership period should be allowed. A valid sale must be absolute in the sense that the ownership of the subject matter must be permanently owned by the buyer indeed.

Finally, we can simplify that the beneficial ownership in common law is different from the beneficial ownership in Islamic law. However, all types of beneficial ownership in Islamic law are consistent with the meaning of beneficial ownership in common law. Common law always differentiate between the true sale and not a true sale transaction. Only a true sale transaction requires the transfer of legal title to the buyer whereby it remains with the seller in the Off-balance sheet transaction which is not a true sale transaction. However, according to Islamic law, both transactions are true sale because the consent to sell and purchase has been given by the contracting parties. When a party buy a property subsequently he becomes the owner of that property even though the legal title remains with the seller and he is not just a beneficial owner but he is the actual owner who legally owns the property. Therefore, the practice of giving the beneficial ownership only in asset-based sukuk with regard to the sale contract should be revised because it is incompatible with Shari'ah principles unless it is applied in a leasing contract whereby the originator leases his assets to the issuer or in the sale of beneficial interest alone then the transfer of beneficial ownership may be applied.

REFERENCES

- AAOIFI. *Accounting and Auditing Organization for Islamic Financial Institutions's Shari'ah Standards*. (Bahrain: AAOIFI. 2008) <http://www.aaofi.com> (accessed on 20th July 2012).
- IFSB. *Islamic Financial Services Board (IFSB)'s Capital Adequacy Standard for Institutions (Other than Insurance Institutions) Offering Only Islamic Financial Services*. (Kuala Lumpur: IFSB, 2009) p.3 <http://www.ifsb.org/standard/ifsb7.pdf> (accessed on 5th July 2012).
- Hussain Hamed Hassan, Comments on Discussion Papers and Notes submitted for Harvard-LSE Workshop on Sukuk, p.4. <http://www.iefpedia.com> (accessed on 12th June 2012).
- Sa'id Bouheraoua & Asyraf Wajdi Dusuki. *Taqwim Naqdi li al-Qadaya al-Shari'iyah al-Muta'alliqah bi Milkiyyah al-Sukuk al-Qa'imah 'ala al-'Usul*, the paper presented at the conference al-Sukuk al-Islamiyyah: 'Arad wa Taqwim organized by University of King 'Abdul 'Aziz, Jeddah, 25th May 2010.

Beneficial Ownership In Asset-Based Sukuk

- Henry Campbell Black, *Black's Law Dictionary*, edited by Bryan A. Garner. (US: Thomson Reuters, 9th ed. 2009).
- The Free Dictionary. <http://encyclopedia.thefreedictionary.com> (assessed on 3rd April 2012).
- Black's Law Dictionary.
- The Village Citizens Advice Bureau, *Beneficial Interest*, <http://www.civilpartnerships.org.uk> (accessed on 19th April 2012)
- NCHGURU, *Legal Interest versus Beneficial Interest*, <http://nchguru.blogspot.com> (accessed on 19th April 2012)
- S.E. Smith, *What Is Beneficial Ownership?*, <http://www.wisegeek.com> (accessed on 19th April 2012)
- Rahail Ali, Sukuk, Islamic Capital Market Series, *Legal Certainty for Sukuk*.
- Frank E. Vogel, *Islamic Law and Finance: Religion, Risk and Return*, (The Hague, Kluwer Law International, 1988).
- Majid Khadduri, *Origin and Development of Islamic Law*, (New Jersey: The Lawbook Exchange, Ltd., 2010).
- Eg. Rabiah Eg. Ali. *Issues in Islamic Debt Securitization*, Essential Readings in Islamic Finance.
- Nik Norzrul Thani & Madzlan, *Legal and Beneficial Ownership of the Underlying Assets in Sukuk Issuance*, 34th IIBF Discussion series on 6th January 2012, (Kuala Lumpur : Zaid Ibrahim & Co).
- Business Link, Bankruptcy: The Basics, <http://www.businesslink.gov.uk> (accessed on 20th April 2012)
- Dusuki & Mokhtar, *Critical Appraisal of Shari'ah Issues on Ownership in Asset Based Sukuk As Implemented In the Islamic Debt Market*
- SAC, Shariah Resolutions in Islamic Finance, *Issuance of Bank Negara Negotiable Notes Based on Ijarah Concept* <http://www.bnm.gov.my> (accessed on 19th May 2012)
- Al-Kasani, Abu Bakr bin Mas'ud, *Bada'ir al-Sana'is*, (Beirut: Dar al-Kutub al-'Ilmiyyah, 2nd ed. 1986), vol.4
- Al-Marghinani, 'Ali bin Abi Bakr, *Al-Hidayah fi Sharh Bidayah al-Mubtadi*, (Beirut: Dar Ihya' al-Turath al-'Arabi, n.d).
- Nakheel Principal Terms and Conditions (PTC), p.8, <http://blogs.thenational.ae> (accessed on 28th May 2012).
- Omar Salah, *Dubai Debt Crisis: A Legal Analysis of the Nakheel Sukuk*, Berkeley Journal of International Law PUBLICIST, p.30. <http://bjil.typepad.com> (accessed on 20th July 2011).
- Mustafa and friends, *al-Mu'jam al-Wasit*, (Dar al-Da'wah, n.d).
- Ahmad Mukhtar, *Mu'jam al-Lughah al-'Arabiyyah al-Mu'asarah*, (Saudi Arabia: 'Alam al-Kutub, 2008).
- Sanu, Qutub Mustafa, *al-Muddakharat Ahkamuha wa turuq Takwiniha wa Istithariha fi al-Fiqh al-Islami*, (Beirut: Dar al-Nafa'is, 2001) p.97.
- Al-Zuhayli, Wahbah, *Al-Fiqh al-Islami Wa Adillatu*, (Damascus: Dar al-Fikr, 4th ed. 1997).
- Al-Qarafi, Ahmad bin Idris, *Anwar al-Buruq fi Anwa' al-Furuq*, (Saudi Arabia: 'Alam al-Kutub, n.d).

- Al-Suyuti, °Abd. Rahman bin Abi Bakr, *Al-Ashbah wa al-Nazair*, (Beirut: Dar al-Kutub al-°Ilmiyyah, 1990).
- Al-Dusuqi, *Hashiah al-Dusuqi °ala al-Sharh al-Kabir*.
- Abu al-Ma°ali, Mahmud bin Ahmad, *al-Muhit al-Burhani, fi al-Fiqhi al-Nu°mani*, (Beirut: Dar al-Kutub al-°Ilmiyyah, 2004).
- Al-Nawawi, Yahya bin Sharaf, *Al-Majmu° Sharh al-Muhazzab*, (Beirut: Dar al-Fikr, n.d), vol.14.
- Ibn Qudamah, °Abdurrahman bin Muhammad, *al-Sharh al-Kabir°ala Matni al-Muqni°*, (Beirut: Dar al-Kitab al-°Arabi, n.d).
- Ibn °Abidin, Muhammad Amin bin °Umar, *Hashiah radd al-mukhtar °Ala al-durr al-mukhtar*, (Beirut: Dar al-Fikr, 2nd ed., 1992)
- Al-Sharbini, Muhammad bin Ahmad, *Mughni al-Muhtaj*, (Beirut: Dar al-Kutub al-°Ilmiyyah, 1994)
- Al-Buhuti, Mansur bin Yunus, *Kasshaf al-Qina°°An Matni al-Iqna°*, (Beirut: Dar al-Kutub al-°Ilmiyyah, n.d).
- Al-Dusuki, Muhammad bin Ahmad, *Hashiah al-Dusuki °Ala Sharh al-Kabir*, (Beirut: Dar al-Fikr, n.d).
- <http://www.islamicport.com> (accessed on 14th May 2012).
- Ibnu Hajar al-Haytami, Ahmad bin Muhammad, *Tuhfatu al-Muhtaj fi Sharh al-Minhaj*, (Egypt: Maktabah al-Tijariyyah al-Kubra, 1983).
- Al-Subki, °Abdul Wahhab bin Taqiyuddin, *al-Ashbah wa al-Nazair*, (Beirut: Dar al-Kutub al-°Ilmiyyah, 1991).
- Al-Bajuri, Ibrahim, *Hashiah al-Bajuri °ala Sharh al-Ghazzi °Ala Matni Abi Shuja°*, (Bulaq, Egypt: Matba°ah al-Amiriyyah, 5th ed., n.d).
- Al-Shatiri, Muhammad bin Ahmad, *Al-Yaqut al-Nafis fi Mazhab Ibni Idris*, (Jeddah: °Alam Ma°rifah, 4th ed., 1981).
- Al-Mawardi, °Ali bin Sulayman, *al-Insaf fi Ma°rifah al-Rajih mina al-Khilaf*, (Beirut: Dar Ihya° al-Turath al-°Arabi, n.d).
- Ibn Nujaym, Zaynuddin bin Ibrahim, *Al-Bahr al-Ra°iq Sharh Kanz al-Daqaiq*, (n.p: Dar al-Kitab al-Islami, n.d).
- Al-Hasfaki, Muhammad bin °Ali, *Al-Durr al-Muntaqa bi Hamish Majma° al-Anhar*, (n.p, n.d).
- Ibnu Majah, Muhammad bin Yazid, *Sunan Ibn Majah*, (Beirut: Dar Ihya° al-Kutub al-°Arabiyyah, n.d).