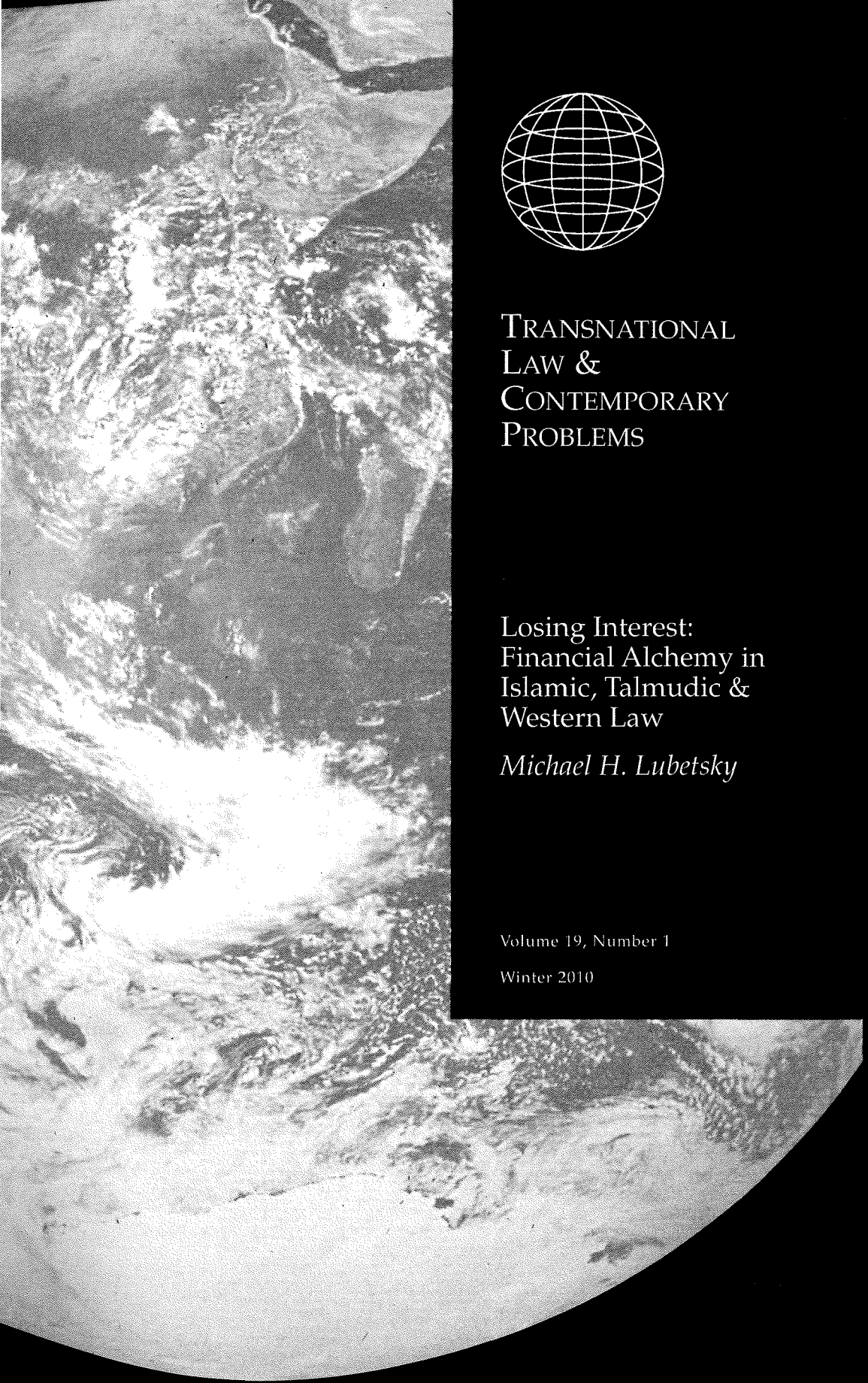

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Losing Interest: Financial Alchemy in Islamic, Talmudic & Western Law

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ABSTRACT

To comply with a Quranic ban on interest, financiers throughout the Muslim world have developed a wide range of legal arrangements, such as

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murabaha and *ijara*, that repackage interest as profits-on-trade. These and other interest-avoiding transactions also appear in a variety of contexts in the West, including tax planning, usury avoidance, and corporate accounting. This Article illustrates how a legal tradition's fundamental attitudes toward law affect its interest-avoiding transactions. This Article argues that, in contrast with other legal normative orders, Islamic law has developed a conspicuously tolerant attitude toward interest-avoiding transactions due to (a) its formalist approach to legal interpretation, and (b) its understanding of law as ordering rather than actualizing.

I. INTRODUCTION

> That they took usury, though they were forbidden; and that they devoured men's substance wrongfully; we have prepared for those among them who reject faith a grievous punishment.[1]

Compare the cases of Alex and Ahmed, both of whom want to buy a house worth $100,000. Alex goes to a bank, takes out a one-year loan of $100,000 at 5 percent interest, and uses the money to buy the house. Ahmed goes to an Islamic bank and arranges for the bank to purchase the house for $100,000 and to immediately resell it to him at a 5 percent mark-up, payable next year. The cash flows are identical,[2] yet to a Muslim, the two transactions have very different legal and spiritual consequences. In Alex's case, the 5 percent premium constitutes interest, which renders the contract void under Islamic law ("*sharia*") and potentially earns Alex and his banker a reservation in Hell. In Ahmed's case, however, the 5 percent premium constitutes a legitimate trading profit of a *bai' bithaman ajil* financing contract. How can these two essentially identical transactions have such different consequences?

The debate over what constitutes interest extends far beyond the Muslim world. Talmudic and Canon law include bans on interest, which Jewish and Christian lenders alike have long sought to circumvent. Modern financiers continue to use a variety of stratagems to exact interest in excess of that allowed by criminal and civil usury statutes. Corporate accountants have numerous incentives to classify financing costs as something other than interest to improve financial ratios. Whether a certain cash flow constitutes

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[1] *Quran* 4:161 (Abdullah Yusuf Ali trans.).

[2] Conceivably, the transactions could produce different consequences if either man pays his debt late. Alex's loan will invariably accrue interest at a daily rate, while Ahmed's invoice may accrue late payment penalties according to a more complicated schedule. Moreover, if a defect is found in the house, Ahmed could, in theory, invoke the seller's warranty against the bank rather than the original owner. In practice, however, the cost of this risk "can be transferred back to the original seller or forward to the buyer." MAHMOUD A. EL-GAMAL, ISLAMIC FINANCE: LAW, ECONOMICS, AND PRACTICE 68 (2006) [hereinafter EL-GAMAL, ISLAMIC FINANCE].

interest also has enormous consequences, either positive or negative, in tax planning.

A review of these disparate situations, however, reveals that different legal traditions have tended to adopt different approaches to interest-avoiding transactions, with *sharia* law, in particular, taking a conspicuously permissive approach compared to others. Some or all of the mark-up in Ahmed's *bai' bithaman ajil* contract, for example, would almost certainly be deemed interest by an accountant, a Western jurist, or a rabbi. A closer look at some of the underlying principles of Islamic legal doctrine and a comparison with other modes of legal thinking can help explain why *sharia* has developed such a permissive attitude.

To facilitate this analysis, Part I of this Article provides a brief overview of the bans or restrictions on interest in various legal traditions. Part II proposes a two-dimensional typology of normative orders, uses it to classify *sharia*, Talmudic law ("*halakha*"), Western law, and Generally Accepted Accounting Principles ("GAAP"), and formulates hypotheses on how the typology can predict attitudes towards interest-avoiding fictions. Part III tests the hypotheses using the doctrine and jurisprudence of the four identified legal traditions. The analysis ultimately shows that Islam's ready acceptance of interest-avoiding transactions results from its formalist attitude towards legal interpretation and its ordering vocation—a combination of qualities that distinguish *sharia* from other major legal traditions.

II. RESTRICTIONS ON INTEREST IN DIFFERENT LEGAL TRADITIONS

A. Sharia

Islam's ban on interest stems from three passages in the Quran that forbid *riba* (رِبًا, literally "increase" or "growth"),[3] which subsequent Islamic scholarship divided into *riba al-nasi'a* (interest on loans) and *riba al-fadl* (unequal exchange of commodities).[4] The exact definition and scope of both forms of *riba* have generated centuries of animated debate.[5] In modern times, however, leading *sharia* jurisprudence from Egypt[6] and Pakistan[7] concur

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[3] *Quran* 2:276–79, 4:161, 30:39. On the literal meaning of the Arabic word *riba*, see Barbara L. Seniawski, *Riba Today: Social Equity, the Economy, and Doing Business Under Islamic Law*, 39 COLUM. J. TRANSNAT'L L. 701, 707 (2001).

[4] Seniawski, *supra* note 3, at 709–10; EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 49–52.

[5] Seniawski, *supra* note 3, at 707–19.

[6] Case no. 20, decision no. 1, of May 4, 1985, Supreme Constitutional Court (Egypt), *reprinted in* 1:1 ARAB QUARTERLY 100 (1985).

[7] Text of the Historic Judgment on Interest Given by the Supreme Court of Pakistan, *available at* http://albalagh.net/Islamic_economics/riba_judgement.shtml (last visited Jan. 29, 2010) (discussing Judge Muhammad Taqi Usmani's opinion in Ur-Rahman Faisal v. Sec'y, Minister of

that *riba* includes all forms of interest on a debt, including "any amount, however little, stipulated in addition to the principal in a transaction of loan."[8] Notwithstanding dissenting opinions,[9] including a decision from the Dubai Court of Cassation,[10] this definition represents the dominant view among Muslim jurists today, particularly in countries that aspire or purport to implement *sharia* law.[11]

Because of the ban on *riba*, borrowers and lenders alike in the Muslim world have sought to structure their financing transactions so as to repackage the interest as trading profit.[12] The most common structures include the *mudaraba* (similar to a preferred shareholding), *murabaha* (commissioned purchase and resale), *ijara* (sale-and-leaseback), *tawarruq* (commodity-intermediated loan), *istisna* (contract for manufacture), and *salaam* (forward purchase).[13] Through careful structuring of these transactions, Islamic financiers can also create various forms of *sukuk*, which is securitized debt, that is virtually indistinguishable from simple debentures.[14]

B. Western Law

Western law, in both its common and civil law manifestations, has long featured interest regulation.. In the civil law tradition, polemics against usury date back to Roman times. Roman law banned interest altogether in the *Lex Genucia* of 340 B.C.E., but eventually established a legal rate of 1 percent per month.[15] Lending, even at the legal rate, came under attack with the advent of Christianity, as the Catholic Church strongly condemned usury

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Law, Justice & Parliamentary Affairs, Gov't of Pak., PLD 1992 PLD FSC 89 (Pak.). The case as reported in Pakistan Law Digest ("PLD") only contains the order and not the complete opinion.) [hereinafter Supreme Court of Pakistan Judgment on Interest].

[8] *Id.* ¶ 106. Note, however, that Justice Usmani did leave open the issue of inflation compensation. *See id.* ¶ 180–88.

[9] Seniawski, *supra* note 3, at 717; *see also* Wayne Visser & Alastair McIntosh, *A Short Review of the Historical Critique of Usury*, 8 ACCT. BUS. & FIN. HIST. 175 (1998), *available at* www.alastairmcintosh.com/articles/1998_usury.htm; Mahmoud A. El-Gamal, *"Interest" and the Paradox of Contemporary Islamic Law & Finance*, 27 FORDHAM INT'L L.J. 108, 109 (2003) [hereinafter El-Gamal, *Interest and the Paradox*].

[10] Dubai Court of Cassation Judgment No. 321/99 (Dec. 19, 1999), *in* RICHARD PRICE & ESSAM AL TAMIMI, UNITED ARAB EMIRATES COURT OF CASSATION JUDGMENTS 1998–2003 206 (2005).

[11] Seniawski, *supra* note 3, at 717; NORZRUL THANI ET AL., LAW AND PRACTICE OF ISLAMIC BANKING AND FINANCE 155–56 (2003).

[12] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, *passim.*

[13] *Id. passim.*

[14] *See id.* at 97.

[15] LOUIS COULAZOU, L'INJUSTICE USURAIRE EN FACE DU DROIT CANONIQUE ET DU DROIT SÉCULIER 14 (1920); *see also* Visser & McIntosh, *supra* note 9, at 176–77; THE THEODOSIAN CODE AND NOVELS AND THE SIRMONDIAN CONSTITUTIONS 61–62 (Clyde Pharr ed., 2001).

and campaigned against it with ever-increasing vigor throughout the Middle Ages.[16] The 1311 Church Council of Vienna declared usury a violation of both divine and human law and ordered the excommunication of all public officials who allowed lending on interest in their jurisdictions.[17] However, reformation and industrialization ultimately motivated the legalization of interest-based lending, beginning in Austria in 1787 and continuing in France during the Revolution.[18] By the late 19th Century, most of Europe and Latin America had no maximum interest rate and very little interest regulation in general.[19] However, this state of affairs proved relatively short-lived, and state after state—led, again, by France in 1807—reintroduced criminal and civil regulations capping interest rates or otherwise subjecting loan contracts to judicial scrutiny.[20]

In England, actions for usury originally fell under the primary jurisdiction of the ecclesiastical courts.[21] By the 15th Century, the growth of the commercial class and the resulting demand for credit converted usury into a temporal issue, and Parliament enacted a statutory ban on interest-lending in 1487.[22] Enforcement proved sporadic, however, and the ban gave way to interest regulation with the 1545 Act Against Usury,[23] which allowed loans to bear interest up to 10 percent per annum.

Today, throughout common law jurisdictions, charging interest above a prescribed statutory rate elicits both criminal and civil sanctions.[24] Contracts that exact criminal levels of interest have routinely been found void for reasons of public policy[25] and have exposed lenders to liability for unjust

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[16] COULAZOU, *supra* note 15, at 17–21.

[17] *Id.*; *see also* DECREES OF THE ECUMENICAL COUNCILS (Norman P. Tanner ed., 1990), *available at* www.piar.hu/councils/ecum15.htm; MARCEL LE GOFF, DU MOULIN ET LE PRÊT À INTÉRÊT: LE LÉGISTE: SON INFLUENCE 79 (1905).

[18] W. M. Harrison, *Foreign Usury Laws*, 1 J. SOC. COMP. LEGIS. 215, 219, 299 (1899); *see also* Art. 1904 C. CIV. (Fr.); COULAZOU, *supra* note 15, at 21–25.

[19] Harrison, *supra* note 18, at 215.

[20] *Id.* at 219.

[21] NORMAN JONES, GOD AND THE MONEYLENDERS: USURY AND THE LAW IN EARLY MODERN ENGLAND 47 (1989); GWEN SEABOURNE, ROYAL REGULATION OF LOANS AND SALES IN MEDIEVAL ENGLAND 44–49 (2003).

[22] An Act Against Usury & Unlawful Bargains, 1487, 15 Edw. 3, ch. 5; Act Against Usury, 1495, 11 Hen. 8, ch. 7; *see* JONES, *supra* note 21, at 47–48. On royal regulation of interest prior to this legislation, see SEABOURNE, *supra* note 21, at 27–30.

[23] Act Against Usury, 1545, 37 Hen. 8, ch. 9 §§ 2–4; *see* JONES, *supra* note 21, at 48.

[24] In Canada, for example, contracting to receive or actually receiving interest over 60 percent per annum constitute offenses under the Criminal Code punishable by up to five years in prison. Criminal Code, R.S.C., ch. C 46, §§ 347–49 (1985) (Can.).

[25] D.J. IBBETSON, A HISTORICAL INTRODUCTION TO THE LAW OF OBLIGATIONS 212–13 (1999).

enrichment and violations of consumer protection statutes.[26] Even without prescribing particular limits on interest rates, a variety of statutory provisions allow courts to review and revise loan or credit contracts judged "extortionate and grossly extravagant" or "unconscionable."[27]

In Western law, the characterization of a particular cash flow or accrual as "interest" can also have enormous tax implications. Investors may prefer to have interest revenues repackaged as capital gains[28] or business profits,[29] which generally qualify for lower tax rates than interest income. Borrowers can often also benefit from repackaging interest as capital expenditures, since it may allow for increased accelerated depreciation.[30] A firm with large accumulated losses may prefer to subsume its debt expenses in its capital losses that can be carried forward indefinitely, rather than in its operating losses that can only be carried forward twenty years.[31] On the other hand, since interest is tax deductible and dividends are not, a profitable business can benefit from repackaging its equity financing costs as interest, a form of financial alchemy that can directly increase the firm's value.[32]

To get around interest regulation and for tax planning purposes, Western lenders and borrowers have developed techniques to reconstitute interest as trading expenses or the like. Credit sales were recognized as a form of interest as early as the 13th Century, when Milo of Evesham was charged with usury for selling "his grain more dearly than it was worth on the day when it was sold."[33] Medieval Europe saw *inter alia* the commercialization of

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[26] *See* Kilroy v. A OK Payday Loan Inc., [2007] 278 D.L.R. 193, 2007 BCCA 231 (B.C. Ct. App.) (Can.) (reviewing the leading Canadian jurisprudence on the issue).

[27] Income Tax Act, R.S.C., ch. 1, § 20(1)(c) (1985) (Can.), *available at* http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-1-5th-supp/latest/rsc-1985-c-1-5th-supp.html (defining interest).

[28] In Canada, capital gains are taxable at half the rate as other forms of income. Income Tax Act, ch. 1, § 38. Many other countries have similar rules.

[29] In Canada, a corporation with primarily interest income constitutes a "specified investment business" and does not qualify for the small business deduction. Income Tax Act, ch. 1, § 125.

[30] Many governments allow corporations to depreciate their assets at accelerated rates, thereby creating an indirect subsidy for investment. *See generally* Yoram Margalioth, *Not a Panacea for Economic Growth: The Case of Accelerated Depreciation*, 26 VA. TAX REV. 493, 494–96 (2007). Note that in Canada, however, section 21(1) of the Income Tax Act allows a taxpayer to capitalize interest used to acquire depreciable property. Income Tax Act, ch. 1, § 21(1). This may not be the case, however, in other jurisdictions.

[31] Income Tax Act, ch. 1, § 111(1)(a)–(b); I.R.S. PUBLICATION 550 (2009), *available at* http://www.irs.gov/pub/irs-pdf/p550.pdf; I.R.S. PUBLICATION 536 (2009), *available at* http://www.irs.gov/pub/irs-pdf/p536.pdf.

[32] On the impact of the deductibility of interest on firm value, see STEPHEN A. ROSS ET AL., CORPORATE FINANCE 448–57 (4th ed. 2005).

[33] SEABOURNE, *supra* note 21, at 27.

the mortgage (revocable sale),[34] the *double stoccado* (contracting the loan through a series of artificial sales of a basic good),[35] and forward currency transactions (interest included in the exchange rates).[36] In modern times, financiers have sought to avoid usury and disclosure regulations through ancillary fees, bundling lending with other products like insurance or gift certificates, and direct or indirect non-payment penalties.[37] Tax planners have proven particularly creative in devising new structures to repackage interest. Some prominent examples include: (a) tax-advantaged mutual funds, which use commodity intermediation to convert interest and dividends into capital gains;[38] (b) denominating debt in high interest foreign currencies to convert capital repayments into interest expenses;[39] (c) purchasing bonds through an offshore shell corporation, thereby converting interest income into capital gains;[40] and (d) hybrid preferred shares, whose cash flows have the fascinating quality of being considered interest by the U.S. Internal Revenue Service but dividends by the Canada Revenue Agency.[41]

C. Halakha

Three passages in the Pentateuch form the basis of Jewish law's prohibition of *ribbit* (רבית, same etymology as Arabic *riba*).[42] As explained in the Talmud and other authoritative expositions on Jewish law, the biblical prohibition covers contracts with three essential elements: (a) an agreement;

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[34] Michael Knoll, *The Ancient Roots of Modern Financial Innovation: The Early History of Regulatory Arbitrage*, 87 OR. L. REV. 93, 107–11 (2008).

[35] JONES, *supra* note 21, at 122–23.

[36] JONES, *supra* note 21, at 139–41; *see also* ERIC KERRIDGE, USURY, INTEREST AND THE REFORMATION 12 (2002).

[37] *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 901–02 (2007) (discussing practices by payday lenders to circumvent regulations and regulatory policies).

[38] An example is the TD Corporate Bond Capital Yield Fund, which indirectly invests in interest-paying corporate bonds. The fund purports to convert the interest payments into "capital gains" by "investing in Canadian equity securities and entering into forward contracts under which it will forward sell the equity securities in return for the total return of an investment in units of TD Corporate Bond Pool." TD CANADA TRUST, TD MUTUAL FUNDS SIMPLIFIED PROSPECTUS—FUND PROFILES 12 (2007), *available at* http://www.tdcanadatrust.com/mutualfunds/pdf/fixedincome.pdf.

[39] The Supreme Court of Canada upheld such an interest-creating scheme in Shell Can. Ltd. v. Can., [1999] 3 S.C.R. 622 (Can.). Parliament subsequently added the "Weak Currency Debt" provisions to the Income Tax Act to disallow such transactions. Income Tax Act, R.S.C., ch. 1, § 20.3 (1985) (Can.), *available at* http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-1-5th-supp/latest/rsc-1985-c-1-5th-supp.html.

[40] The Supreme Court of Canada heard a case involving such a scheme in Ludco Enters. Ltd. v. Canada, [2001] 2 S.C.R. 1082, 2001 SCC 62 (Can.).

[41] Interview with R. Michael Teper, M.B.A., LL.B., C.A. (Nov. 23, 2007).

[42] *Exodus* 22:26; *Leviticus* 25:35–37; *Deuteronomy* 23:20; *see also Ezekiel* 18:8. Note that *ribbit* is pronounced *ribbis* in certain Hebrew dialects. *See, e.g.*, REISMAN, *infra* note 43.

(b) at the time of the commencement of the loan; (c) to pay or provide services to the lender in excess of the amount loaned.[43] Such contracts constitute *ribbit ketzutzah* and are strictly prohibited; the contract is void ab initio and the borrower and the lender, as well as the scribe to the contract and any witnesses to the transaction, commit a serious sin.[44] Subsequent rabbinic decrees have further expanded the scope of the ban, forbidding, for example, mark-ups for credit sales,[45] any gift intended to influence the giving of a loan;[46] any gift or service given in thanks for a loan—even after it has been paid off,[47] and praising, complimenting, or offering a blessing to the lender while the loan remains outstanding.[48] Such forms of *ribbit* constitute *ribbit d'rabbanan*, which is also forbidden but features more exceptions and weaker sanctions.[49] It bears note that the prohibition of *ribbit* applies only to transactions between Jews. When transacting with a gentile, a Jew may agree to charge or pay interest without restriction.[50]

As in both the Islamic and Christian cultures, Jewish borrowers and lenders found various ways to circumvent the prohibition on *ribbit*, including revocable sales (virtually identical to the original common law mortgage)[51] and transactions through non-Jewish intermediaries.[52] In the Middle Ages, these approaches mostly gave way to the *heter iska*, a relatively complicated form of equity partnership that serves as the basis of most loan or loan-like transactions between Jews today.[53]

D. Generally Accepted Accounting Principles ("GAAP")

As a normative order, GAAP differs from Western law in both its origins and approaches. Both international[54] and American GAAP are primarily

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[43] YISROEL REISMAN, THE LAWS OF RIBBIS 51–52 (Nossom Sherman & Meir Zlotowitz eds., 1995).

[44] *Id.* at 51, 57.

[45] *Id.* at 59.

[46] *Id.* at 60.

[47] *Id.* at 61.

[48] REISMAN, *supra* note 43, at 68–70.

[49] *Id.* at 50.

[50] *Deuteronomy* 23:20; REISMAN, *supra* note 43, at 94–97.

[51] ZE'EV WILHELM FALK, INTRODUCTION TO JEWISH LAW OF THE SECOND COMMONWEALTH, PART 2 206–07 (1978).

[52] *See generally* Haym Soloveitchik, *Pawnbroking: A Study in Ribbit and of the Halakah in Exile*, 38 PROC. AM. ACAD. FOR JEWISH RES. 203 (1970).

[53] Visser & McIntosh, *supra* note 9, at 177–78.

[54] By "international GAAP," this Article refers primarily to principles enacted by the International Accounting Standards Board. However, the term is less than accurate, since the Board's standards have yet to become "generally accepted." *See* COOK ET AL., IFRS/US GAAP COMPARISON 29–31 (3d ed. 2005).

established by professionals for professionals,[55] rather than by governments for the public good. GAAP primarily evolves not through jurisprudence before tribunals, but rather through ongoing dialogue by practitioners about their clients' new situations and needs.[56] These differences produce a very different approach to the elaboration and interpretation of rules compared to Western criminal or private law.

In GAAP, the classification of a particular cash flow or accrual as interest can have a significant impact upon a firm's key financial metrics, particularly the interest coverage ratio and earnings before interest and taxes ("EBIT"). If firms have the option to report interest as a financing cost rather than as an operating expense, the reclassification of an interest payment can also affect the firm's cash from operations and other ratios that derive from it.[57] Creditors and investors alike make extensive use of these and other metrics when determining debt covenants[58] or stock valuations.[59] Consequently, managers and owners have an incentive to characterize interest expenses in ways that improve the ratios most important to the firm at that time. Transactions that can potentially convert interest into non-interest include the sale of receivables, the sale and repurchase of inventories, long-term purchase commitments, borrowing through subsidiaries and special-purpose vehicles, combining debt with derivatives, like swaps and operating leases.[60]

E. Comparative Overview

All four of the legal and quasi-legal traditions discussed above recognize that "interest" cash flows are somehow different from other forms of trade or

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[55] For an overview of the setting of international and American accounting standards, see *id.* at 31–41. For an overview of the process for setting accounting standards in the United States, see GERALD I. WHITE ET AL., THE ANALYSIS AND USE OF FINANCIAL STATEMENTS 4, 7–10 (special edition for CFA Candidates, 1994). In the United States, the Financial Accounting Standards Board makes clear that equity investors and creditors constitute the primary users of financial statements. FIN. ACCOUNTING STANDARDS BD., OBJECTIVES OF FINANCIAL REPORTING BY BUSINESS ENTERPRISES, STATEMENT OF FIN. ACCT. CONCEPTS NO. 1 (1978), *available at* http://www.fasb.org/pdf/con1.pdf.

[56] *See* COOK ET AL., *supra* note 54, at 31 (distinguishing GAAP from standard-setting bodies that owe their legitimacy to national legislative frameworks and are politically accountable).

[57] Firms can do this under international accounting standards, but not under the U.S. GAAP. *Id.* at 716–17.

[58] Nicolae Gârleanu & Jeffrey Zwiebel, Design and Renegotiation of Debt Covenants (Sept. 2006), *available at* http://faculty.haas.berkeley.edu/garleanu/coven.pdf (unpublished manuscript, University of California Berkeley Hass School of Business); Clifford W. Smith, Jr., *A Consecutive Perspective on Accounting-Based Debt Covenant Violations*, 68 ACCT. REV. 289, 292 (1993).

[59] *See generally* Erik Lie & Heidi J. Lie, *Multiples Used to Estimate Corporate Value*, 58:2 FIN. ANALYSTS J. 44 (2002).

[60] MICHAEL GIBBINS, FINANCIAL ACCOUNTING: AN INTEGRATED APPROACH 595 (5th ed. 2005); *see also Badly in Need of Repair*, ECONOMIST, May 4, 2002, at 66.

rental income, and thus deserve special treatment.[61] However, borrowers and lenders in each culture have developed different tools to circumvent interest regulation. Muslim financiers focus on the *mudaraba*, *murabaha*, and *ijara*.[62] Jewish lenders have perfected the *heter iska*.[63] Traders in medieval Europe developed the *double stoccado*, and their modern successors prefer penalty clauses, service charges, and various manipulations of credit sales.[64] Chartered accountants continue to get considerable mileage out of long-term procurement contracts, especially operating leases.[65] The vast diversity in approaches invites an inquiry into why and how different traditions settled on different solutions.

III. A TYPOLOGY OF LEGAL SYSTEMS

A. *Dimensions of Difference*

This Article classifies legal traditions under two dimensions: (a) the primary method of legal interpretation and (b) the primary understanding of the vocation of law. Table 1 illustrates where the four legal traditions discussed in Part I fall within this typology.

Table 1: Typology of Legal Systems

		Vocation	
		Ordering	**Actualizing**
Interpretive Method	**Formalist**	*Sharia*	*Halakha*
	Substantive	Western Law	GAAP

The interpretive method constitutes the first dimension of difference. A primarily formalist tradition takes the expressed law as a given. It emphasizes the literal meaning of the law's provisions, and privileges the letter of the law over its spirit when the two come into conflict. By contrast, a substantive tradition starts from the premise that laws aim to deal with certain problems or promote certain societal benefits. It thus aims to interpret laws in ways that effectively deal with those problems, even when

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[61] Other legal traditions reach similar conclusions. On interest regulation in Sumerian law, see SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 26–27 (2005). On ancient Greek law, see LUDOVIC BEAUCHET, HISTOIRE DU DROIT PRIVÉ DE LA RÉPUBLIQUE ATHÉNIENNE, vol. IV, 247–48 (1969). On Hindu law, see Visser & McIntosh, *supra* note 9, at 176.

[62] *See supra* Part IIA and accompanying notes.

[63] *See supra* Part IIC and accompanying notes.

[64] *See supra* Part IIB and accompanying notes; *see also* JONES, *supra* note 21, at 122–23; Mann & Hawkins, *supra* note 37, at 901–02.

[65] *See generally Badly in Need of Repair*, *supra* note 60 (discussing the use of off-balance-sheet loopholes such as operating leases by businesses).

the interpretation does not seem fully consistent with the plain language of the text.

The vocation constitutes the second dimension of difference. An ordering legal tradition views the law as a tool to set the ground rules of a just society. It places a high value upon individualism and autonomy, and establishes that the law permits whatever it does not forbid. Such a tradition views law as essentially onerous, even if necessary for the betterment of society. By contrast, an actualizing legal tradition places considerably less value upon individual choice and diversity, and maintains that laws ought to reflect and guide how people should act in any given situation. The silence of the law on a particular subject does not necessarily imply that individuals can do whatever they want, but only that the law has not been fully articulated. Rather than as a burden, the law is seen as a primary vehicle for individual and collective self-actualization.

B. Classification of the Legal Traditions

All four legal traditions contain formalist, substantive, ordering, and actualizing elements. For example, Canadian courts, as part of the Western tradition, have adopted a very formalist approach to interpreting the Income Tax Act,[66] but a more substantive approach when dealing with constitutional freedoms.[67] *Sharia* commercial law reveals an ordering orientation due to the premium it places on freedom of contract,[68] while *sharia* law of inheritance exhibits a striking lack of flexibility, which is suggestive of an actualizing vocation.[69]

A legal tradition's interpretive methods and vocation can also change over time. A century ago, for example, Western contract law featured a very formalist approach, epitomized by the parole evidence rule. Today, in contrast, judges take a more substantive approach, affording more weight to the unspoken intentions and assumptions of the parties.[70] It bears emphasis, therefore, that the classification of the traditions can only take place at the highest level of generality.

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[66] *See, e.g.*, Imperial Oil Ltd. v. R., [2006] 2 S.C.R. 447, 2006 SCC 46, paras. 25–30 (Can.); Income Tax Act, R.S.C., ch. 1, § 20(1)(c) (1985) (Can.), *available at* http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-1-5th-supp/latest/rsc-1985-c-1-5th-supp.html.

[67] *See, e.g.*, Canada (Combines Investigations Act, Dir. of Investigation and Research) v. Southam, [1984] 2 S.C.R. 145, paras. 18–20 (Can.).

[68] *See* MOHAMMAD HASHIM KAMALI, ISLAMIC COMMERCIAL LAW: AN ANALYSIS OF FUTURES AND OPTIONS 68–70 (2000).

[69] *See generally* U.N. Human Settlements Programme, *Islamic Inheritance Laws and Systems*, 10–11 (Islamic Land & Property Research Series, No. 6, 2005), *available at* http://www.unhabitat.org/downloads/docs/3546_3490_ILP%206.doc.

[70] *See generally* Eric A. Posner, *The Decline of Formality in Contract Law*, *in* THE FALL AND RISE OF FREEDOM OF CONTRACT 61, 65 (F. H. Buckley ed., 1999).

1. Method of Interpretation: Formalist vs. Substantive

Sharia and *halakha* both feature primarily formalist approaches to interpretation. Each legal framework is grounded in a written document—the Quran and the Torah respectively—believed to be God's word, revealed letter-by-letter.[71] Both faiths supplement their sacred texts with an authoritative commentary—the *sunna* and the Oral Torah—originally transmitted orally, but eventually set to writing as the *hadith* for Islam and the *mishnah* for Judaism.[72] Both faiths consider their revealed law as eternal, immutable, and suitable for all humanity from now until the end of days. Both faiths also feature large bodies of ritual law that, being deeply rooted in tradition and symbolism, lend themselves primarily to more formalist forms of interpretation.[73] Although Jews and Muslims would agree that their respective texts require exegesis, interpretations cannot deviate excessively from the literal meaning of the text without calling into question the truth of God's word. Consequently, legal interpretation in both faiths remains solidly anchored in the sacred texts and the meaning of the words used to express the law, rather than in the unarticulated societal benefits that the law seeks to achieve.

Wael B. Hallaq explains how formalist approaches guide the exposition and elaboration of Islamic law. When confronted with a novel situation, the jurist must identify the most relevant text available and subject it to a rigorous linguistic analysis,[74] starting with the presumption that words are used in their plain sense.[75] Issues of meaning and grammar dominate legal discussion. As Hallaq points out, "There are few topics in Islamic legal theory that succeeded in arousing so much controversy as the issue of the imperative form."[76] After identifying the relevant text and clarifying its meaning,[77] the jurist uses the *qiyas* analogical method to determine whether and how the text may apply to a different scenario.[78] Under the principle of suitability

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[71] Regarding the Quran, see M. Cherif Bassiouni & Gamal M. Badr, *The Shari'ah: Sources, Interpretation, and Rule-Making*, 1 UCLA J. ISLAMIC & NEAR E.L. 135, 147–50 (2002). Regarding the Torah, see Samuel J. Levine, *Jewish Legal Theory and American Constitutional Theory: Some Comparisons and Contrasts*, 24 HASTINGS CONST. L.Q. 441, 444–45 (1996).

[72] Regarding the *sunna* and *hadith*, see Bassiouni & Badr, *supra* note 71, at 150–53. Regarding the Oral Torah and the *mishnah*, see Levine, *supra* note 71, at 445.

[73] Levine, *supra* note 71, at 462.

[74] WAEL B. HALLAQ, A HISTORY OF ISLAMIC LEGAL THEORIES: AN INTRODUCTION TO SUNNI *USUL AL-FIQH* 42 (1997).

[75] *Id.* at 43.

[76] *Id.* at 48.

[77] *Id.* at 82. Analysis of the verse in question must also take into consideration related verses, previous consensus, further detail provided in the *hadith*, and whether the verse has been abrogated by another. *Id.*

[78] HALLAQ, *supra* note 74, at 83.

(*munasaba*), the process of *qiyas* may sometimes involve consideration of the underlying good that a particular rule sought to achieve; however, only in certain situations may the jurist resort to *munasaba*, and its general appropriateness has long been the subject of controversy.[79] A consensus developed early in Islamic history requires that all legal rulings be based upon an authoritative revealed source, either the Quran or the *sunna*.[80] Consequently, the promulgation of new religious rules relied less on traditional pre-Islamic sources of law and methods of legal reasoning, such as *istihsan* and *istislah* (juristic preference and public welfare).[81] The 10th Century decline of "individual independent reasoning or personal interpretations" as a source of law, combined with what has been dubbed the "closing of the door" of *ijtihad*,[82] further institutionalized formalist approaches to legal interpretation.[83]

Classical Islamic exposition on the scope of the ban on *riba al-fadl* ("exchange *riba*") illustrates the prevalence of the formalist over substantive approach. According to accepted *hadith*, the Prophet Muhammad forbade unequal exchanges of gold, silver, wheat, barley, dates, and salt.[84] When considering the scope of this rule, Hanbali and Hanafi schools concluded, by analogy, that the ban actually only applies to goods that can be weighed or measured by capacity.[85] The Maliki and Shafi'i schools, by contrast, hold that the ban extends only to goods used as currency (gold and silver) or storable foodstuffs (wheat, barley, dates, and salt).[86] Consequently, the Hanbali and Hanafi schools believe that the ban extends to unequal exchanges of fabric or lumber but not to paper money, while the Maliki and Shafi'i schools come to the opposite conclusion. It seems noteworthy that none of the traditions seems to have interpreted the *hadith* to include "goods exchanged between parties with unequal bargaining power" or "goods that constitute necessities of life"—approaches which may have allowed for a more purposive application of the law.

In comparison with *sharia*, Jewish law gives considerably more power to its religious and political leaders to extend, supplement, and adapt the

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[79] *Id.* at 88–90; *see also* Bassiouni & Badr, *supra* note 71, at 143–45.

[80] HALLAQ, *supra* note 74, at 30–33.

[81] Bassiouni & Badr, *supra* note 71, at 136.

[82] *Id.*

[83] *Id.* at 165; *see also* Noor Mohammed, *Principles of Islamic Contract Law*, 6 J.L. & RELIGION 115, 125 (1988).

[84] *Sahih Muslim* 10:3853 (Abdul Hamid Siddiqui trans.), *available at* http://www.usc.edu/schools/college/crcc/engagement/resources/texts/muslim/hadith/muslim/010.smt.html.

[85] Seniawski, *supra* note 3, at 711.

[86] *Id.*

revealed law in light of changing or exceptional circumstances.[87] Nevertheless, like *sharia*, *halakha* takes a fundamentally formalist approach to legal interpretation. The words of the Torah constitute both the starting and ending reference point for any discussion of law, and hermeneutics feature prominently in Talmudic legal reasoning.[88] Like the *sunna*, the oral Torah provides an authoritative explanation of the written Torah's teachings and supersedes rabbinic innovation.[89] The Talmud records several debates between Rabbi Simon and Rabbi Judah over what scope an unstated "purpose" of a commandment should have in its interpretation.[90] For example, the rabbis discussed whether the biblical law against taking a pledge from a widow applies when the widow is rich.[91] The Talmud ultimately concluded that when a biblical rule is clearly stated, compliance is mandatory, even when the supposed rationale does not appear to be relevant to specific circumstances of the parties or to broader realities of the present day.[92]

Halakha's treatment of *ribbit* exemplifies this formalist approach to legal interpretation. Talmudic exposition limited the biblical prohibition to *ribbit ketzutzah*—interest paid pursuant to an agreement made at the time of the loan.[93] The rabbis have banned other forms of interest by decree, but have made clear that these violations constitute only *ribbit d'rabbanan*, which carries weaker sanctions.[94] A truly substantive approach to legal interpretation would have made the distinction between the two forms of *ribbit* unnecessary. Moreover, although it carries more serious sanctions, no one seems to argue that *ribbit ketzutzah* is more demonstrably harmful to society than *ribbit d'rabbanan*. To the contrary, the lack of transparency involved in giving a gift to influence the issuing of a loan (a form of *ribbit d'rabbanan*) seems more inimical to the functioning of the economy than interest on a government bond (a form of *ribbit ketzutzah*). Therefore, the difference between the two forms of *ribbit* and their different sanctions rests upon purely formalist distinctions, rather than a purposive application of the law.

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[87] *See* AARON KIRSCHENBAUM, EQUITY IN JEWISH CIVIL LAW: HALAKHIC PERSPECTIVES IN LAW: FORMALISM AND FLEXIBILITY IN JEWISH LAW 9–15, 21–26 (Norman Lam ed., 1991).

[88] Levine, *supra* note 71, at 445, 448.

[89] *Id.* at 447.

[90] *Id.* at 458–59.

[91] *Deuteronomy* 24:10. The Talmudic debate appears in the Babylonian Talmud, *Baba Metzia* 115A (Salis Daiches & H. Freedman trans.), *available at* http://ww.come-and-hear.com/babamezia/babamezia_115.html.

[92] *Id.*

[93] REISMAN, *supra* note 43, at 51, n.3.

[94] *Id.* at 58.

Modern Western law, in contrast, features a primarily substantive approach to legal interpretation. In both common law and civil law contexts, statutory interpretation places strong emphasis on giving effect to the will of the legislature, rather than the text of the statute.[95] Under the "mischief rule," first articulated in the 16th Century, courts have the responsibility to look into the harm that the legislature sought to address in a particular piece of legislation and tailor its interpretation to achieve the legislature's objectives.[96] Courts have the authority to correct statutes which have been improperly drafted—substituting what the legislature meant for what it actually wrote—a power inconceivable in the Jewish and Islamic legal traditions.[97] Numerous statutes explicitly confer upon judges and/or administrative officials the discretionary power to modify or even waive statutory guidelines when they deem it necessary to achieve the statute's ultimate purposes.[98]

GAAP also calls for a primarily substantive approach to the application of its rules. The fundamental objectives of accounting norms—the production of a conservative and accurate portrayal of a firm's financial position and performance—constitute the starting point for any discussion of accounting standards.[99] When a formalistic application of an accounting rule produces a potentially misleading statement, the professional accountant has an obligation not to follow the rule. This principle finds a particularly strong expression in section 203 of the Code of Conduct of the American Institute of Certified Public Accountants:

> However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper

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[95] *See, e.g.*, PIERRE-ANDRÉ COTÉ, THE INTERPRETATION OF LEGISLATION IN CANADA 7 (3d ed. 1999).

[96] *Id.*; Heydons Case, (1584) 3 Eng. Rep. 7a (K.B.).

[97] *See, e.g.*, R. v. McIntosh, [1995] 1 S.C.R. 686, ¶ 76 (Can.).

[98] Examples include the child support payment rules in the Federal Child Support Guidelines, SOR/1997-175, §§ 4(b), 10 (Can.), *available at* http://www.canlii.org/en/ca/laws/regu/sor-97-175/latest/sor-97-175.html, and selection criteria for immigrants in the Immigration and Refugee Protection Regulations, SOR/2002-227, §§ 76(3), 87(3), 109 (Can.), *available at* http://www.canlii.org/en/ca/laws/regu/sor-2002-227/latest/sor-2002-227.html.

[99] *See* PETER D. EASTON ET AL., FINANCIAL ACCOUNTING FOR MBAS 1–26 (4th ed. 2010).

> accounting treatment is that which will render the financial statements not misleading.[100]

More recently, the U.S. Securities and Exchange Commission ("SEC"), in a report to Congress mandated by the Sarbanes-Oxley Act of 2002,[101] outlined its vision for future accounting standards:

> In our minds, an optimal standard involves a concise statement of substantive accounting principle where the accounting *objective* has been included at an appropriate level of specificity as an integral part of the standard and where few, if any, exceptions or conceptual inconsistencies are included in the standard. Further, such a standard should provide an *appropriate amount of implementation guidance* given the nature of the class of transactions or events and should be devoid of bright-line tests. Finally, such a standard should be consistent with, and derive from, a coherent conceptual framework of financial reporting.[102]

The SEC has labeled this approach to financial standard-setting "objectives-oriented,"[103] which stands in marked contrast to the literal adherence to written rules that characterize formalistic approaches to law.

2. Vocation: Ordering vs. Actualizing

An ordering legal system characterizes itself as setting the "rules of the game" that allow society to function and flourish. This conception of law recognizes the value of personal freedom and individuality; it allows whatever it does not forbid and makes optional whatever it does not obligate. Modern Western law, particularly in an age that enshrines free markets and constitutionally-protected civil liberties, represents the paradigmatic ordering legal system. At the opposite end of the spectrum, GAAP has a quintessentially actualizing purpose. It does not aspire to foster accounting diversity, but to set common standards to facilitate transparency and meaningful comparisons between firms and fiscal periods.[104] Indeed, the

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[100] AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, CODE OF PROFESSIONAL CONDUCT § 203 (1988), *available at* www.aicpa.org/about/code/et_203.html.

[101] Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7218(d) (2002).

[102] U.S. SEC. & EXCH. COMM'N, STUDY PURSUANT TO SECTION 108(D) OF THE SARBANES-OXLEY ACT OF 2002 ON THE ADOPTION BY THE UNITED STATES FINANCIAL REPORTING SYSTEM OF A PRINCIPLES-BASED ACCOUNTING SYSTEM, at Executive Summary (2003), *available at* http://www.sec.gov/news/studies/principlesbasedstand.htm.

[103] *Id.*

[104] *See* EASTON ET AL., *supra* note 99, at 1–26.

modern history of accounting has witnessed ever-increasing standardization, including the recent development of international accounting standards.[105]

In contrast to Western law, *sharia* appears to constitute an actualizing legal order. It is typically described as "a comprehensive code of conduct for Muslims in their social, political & economic orbits,"[106] with rules placing less emphasis upon individual rights and more upon community welfare.[107] Nevertheless, a closer look reveals that both *sharia* and Western law primarily serve an ordering function. *Sharia* places a strong value upon freedom of contract[108] and freedom of religion,[109] and enshrines as a fundamental principle that the law permits whatever it does not forbid.[110] While some of its provisions may strike Westerners as intrusive and draconian, Islam describes itself as a "light" and "easy" religion to follow, and has developed the doctrines of *taysir* (bringing ease) and *raf al-haraj* (removal of hardship) to guide legal interpretation.[111] These doctrines reveal that although Islam recognizes the importance of law and the good it brings, it nevertheless views rules and regulations as essentially onerous. *Sharia* also developed the doctrine of *istishab* (continuity), which imposes the burden of proof upon anyone seeking to change a law, and thus further hinders the promulgation of new rules.[112] The *sharia*'s ordering vocation finds a clear expression in the Quran itself, which states:

> Those are *limits* set by Allah. Those who obey Allah and His Messenger will be admitted to Gardens with rivers flowing beneath, to abide therein (for ever) and that will be the supreme achievement. But those who disobey Allah and His Messenger and transgress His *limits* will be admitted to a Fire, to abide therein: And they shall have a humiliating punishment.[113]

The use of the term "limits" reveals that Islam views *sharia* as essentially setting boundaries for individual and collective endeavors, rather than

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[105] *See, e.g.*, COOK ET AL, *supra* note 54, at 45–46.

[106] Mahmood Faruqui, *Demystifying the Islamic Finance Value Proposition*, 1 SHIRKAH 34, 35 (2006), *available at* http://www.shirkah-finance.com/Shirkah%20n%2001.pdf.

[107] Jason Morgan-Foster, *A New Perspective on the Universality Debate: Reverse Moderate Relativism in the Islamic Context*, 10 ILSA J. INT'L & COMP. L. 35, 54–57 (2003); *see also* Bassiouni & Badr, *supra* note 71, at 158–59.

[108] KAMALI, *supra* note 68, at 66–70, 74–77; *see also Quran* 4:29 ("Let there be trade among you by mutual consent.").

[109] *Quran* 2:257 ("There is no compulsion in religion.").

[110] KAMALI, *supra* note 68, at 72.

[111] *Id.* at 70–74.

[112] HALLAQ, *supra* note 74, at 113–15.

[113] *Quran* 4:13–14 (emphasis added).

regulating exhaustively how people must conduct themselves in any given situation.

Halakha, in contrast, reflects an actualizing vocation. The Torah establishes numerous principles and structures that foster the continuous promulgation of new law.[114] As one scholar notes, *halakha* consists of "a body of established and in-the-process-of being established standards for communal behaviour."[115] Notwithstanding the considerable diversity of opinion within Jewish law and practice, autonomy and diversity do not have the same prominence as in Islam; Jewish scripture has no ready equivalent to Islam's canonical principle that "[t]here is no compulsion in religion"[116] or that "[d]ifference of opinion in my Community is a mercy for my people."[117] The holiest prayer in the liturgy, the *shema*, exhorts Jews twice daily, "You will not follow after the yearnings of your hearts and your eyes, that lead you astray."[118] The very word "freedom" in Jewish theology—celebrated with great ceremony during the annual Passover festival—refers not to an individual's right to do as he or she wishes, but rather the ability to fulfill God's commandments.[119] To portray the myriad laws that a Jew must obey as burdensome has long been associated with the heretical views of the Biblical villain Korah, who ultimately saw himself and his followers swallowed up by the earth.[120] All these features suggest that, at *halakha*'s most fundamental level, it does not characterize law as a collection of limits on society. Rather, law is characterized as a collection of goals to which all members of society must aspire.

C. *Hypotheses*

Prima facie, a legal tradition's interpretive method and vocation suggest how the tradition should regard interest-avoiding transactions like the *murabaha*, *heter iska*, sale-and-leaseback, or loan service charges. A formalist and ordering law, like *sharia*, generally should prove the most accepting of such transactions, due to its restrictive approach toward law in general and its emphasis of form over substance. At the other extreme, a substantive and

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[114] KIRSCHENBAUM, *supra* note 87, at 9–15.

[115] Louis Newman, *A Review of Robert Gibbs 'Why Ethics?'*, 2 J. TEXTUAL REASONING (2003), *available at* http://etext.lib.virginia.edu/journals/tr/volume2/newman.html.

[116] *Quran* 2:256.

[117] For a list of the various sources in Islamic law that report this *hadith*, see G.F. Haddad, *Madhhab Differences in Islam*, LIVING ISLAM, Dec. 5, 1996, http://www.livingislam.org/mdf_e.html.

[118] *Numbers* 15:40.

[119] JOSEPH P. SOLOVEITCHIK, FESTIVAL OF FREEDOM: ESSAYS ON PESAH AND THE HAGGADAH 54 (Joel B. Wolowelsky & Reuven Ziegler eds., 2006).

[120] *Numbers* 16:1–40; *see also* Morris Jastrow, Jr. et al., *Korah*, *in* JEWISH ENCYLOPEDIA (1901), *available at* http://www.jewishencyclopedia.com/view.jsp?artid=362&letter=K.

actualizing law, like GAAP, should prove the least accepting of interest-avoiding schemes, since the law has little difficulty interpreting existing rules and/or creating new rules to cover novel situations. A formalist and actualizing tradition, like the *halakha*, represents an intermediate case. Due to its formalist orientation, it would also tend to take interest-avoiding transactions at face value, and thus would accept them. However, its propensity for legal innovation makes it easier for jurists to promulgate new rules that extend interest regulation to interest-avoiding schemes and other interest-like transactions. Of course, financiers may respond by developing increasingly complex schemes to avoid these new rules, creating a sort of tug-of-war. Eventually, as El-Gamal explains, the lawmakers acquiesce, since "[i]t is impossible for the jurist to stop all of those increasingly complex ruses without banning credit or spot sales, which would clearly not be supportable in the overall social cost-benefit analysis."[121] Therefore, one would expect a formalist and actualizing tradition not to recognize simpler forms of interest avoidance, but to accept increasingly complex schemes.

A substantive and ordering legal system, like modern Western law, would likely adopt a very different approach. The ordering vocation militates against a wholesale expansion of law. On the other hand, substantive interpretation invites judges to look beyond the text of interest regulation to its objectives. This approach suggests that interest regulation will be applied contextually. Thus, a particular interest-avoidance transaction may be acceptable in some circumstances but not in others, depending on whether the regulation in question aims to address that kind of situation.

IV. ASSESSMENT OF THE HYPOTHESES

A review of the most popular interest-avoidance schemes that have taken root in the four traditions explored in this Article confirms the validity of the hypotheses raised in the previous section. In general, *sharia* has the most permissive approach to interest-avoiding schemes; GAAP has the least permissive approach; *halakha* tends to accept complex schemes, but not the simpler ones; and Western law takes a contextual approach—strict in some situations and permissive in others.

A. Sharia

Islamic jurists have strictly construed the Quranic ban on *riba*, holding that it includes any interest paid on a debt, including inflation adjustments.[122] However, notwithstanding numerous fulminations against

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[121] Mahmoud A. El-Gamal, *Incoherence of Contract-Based Islamic Financial Jurisprudence in the Age of Financial Engineering*, 25 WIS. INT'L L.J. 605, 620 (2008) [hereinafter El-Gamal, *Incoherence*].

[122] *See* Supreme Court of Pakistan Judgment on Interest, *supra* note 7, paras. 106, 180–88.

"ruses" and "schemes,"[123] *sharia* jurists have ultimately proven to be remarkably accepting of even the most transparent interest-avoiding transactions.

Ahmed's home purchase, discussed at the very beginning of this Article, represents a *bai' bithaman ajil*, a commissioned purchase and resale at a mark-up. It is one of the more, if not the most, popular Islamic banking transaction[124] and is virtually indistinguishable from a standard financing mortgage:

> *Al-Bai' Bithaman Ajil*, or sale with delayed payment, is the closest Islamic analogue to interest finance, and accordingly has been universally employed as a vehicle of finance throughout Islamic history. Nothing in Islamic law dictates how the price for such a sale is determined: it is simply whatever the parties [have] agreed upon. Therefore, nothing prevents the seller from linking the sale price to the period of time for which credit is extended.[125]

The *bai' bithaman ajil* does, however, pose one problem: at the inception of the scheme, the financier commits to sell an object that he or she does not yet own. Such a provision generally is not permitted under *sharia* contract law.[126] However, a Maliki school opinion allows a trade intermediary to obtain a binding promise from his or her customer to purchase the item once acquired.[127] The adoption of this opinion throughout the Muslim world, including in the non-Maliki regions of Malaysia and the Arabian peninsula, made the *bai' bithaman ajil* and related transactions commercially viable forms of Islamic banking.[128]

The *bai' bithaman ajil* closely resembles the *murabaha* contract, another popular transaction in Islamic finance, in which a financier purchases an object and resells it at a pre-arranged mark-up.[129] Pakistan's Federal Shariat Court explicitly approved the *murabaha* in its landmark *Faisal* decision, although it characterized it as a "borderline transaction" that should be used only when equity-oriented partnerships are not available.[130]

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[123] El-Gamal, *Incoherence*, *supra* note 121, at 4–6.

[124] THANI ET AL., *supra* note 11, at 38.

[125] *Id.* at 39.

[126] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 66; THANI ET AL., *supra* note 11, at 39.

[127] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 66–67, 98.

[128] *Id.*

[129] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 67–68; *see also* THANI ET AL., *supra* note 11, at 57–58.

[130] Supreme Court of Pakistan Judgment on Interest, *supra* note 7, para. 227.

Another related transaction, the *bai' al-'ina*, has proven more controversial. In this scheme, the borrower sells an object for cash and immediately repurchases it for a mark-up on credit.[131] The *bai' al-'ina* generated considerable discussion among early Islamic jurists, many of whom—particularly in the Hanbali and Maliki schools—eventually prohibited it on the grounds that it constituted a ruse to circumvent the ban on *riba*.[132] However, the transaction was allowed by the Shafi'i school, which dominates in Southeast Asia, and has become a widespread transaction with Islamic banks in Malaysia.[133]

The *tawarruq*, also known as a "reverse *murabaha*," constitutes another controversial form of ostensibly interest-free financing. In this scheme, the borrower purchases a commodity on credit and sells it to the bank for cash, whereupon the bank immediately resells it on the spot market.[134] These multiple commodity transactions can be effected almost instantaneously through brokers, particularly if the bank acts as agent for all the parties involved; no physical movement of the underlying commodity need take place.[135] The end result is virtually identical to unsecured lending, with the difference between the spot and credit prices constituting the de facto interest. Although a number of jurists have criticized the strategy, some scholars of the Hanbali schools allow it in certain situations, and *tawarruq* has become one of the fastest-growing Islamic banking products in the Gulf region.[136]

The *ijara* contract has generally proven less controversial, although its modern incarnation relies upon another Maliki opinion to make it commercially feasible. In the *ijara*, the financier purchases an object (either from the borrower personally or a third party) and then rents it to the borrower.[137] The financier also commits to sell or give the object back to the borrower upon expiration of the rental contract.[138] This terminal clause again raises the problem that the financier is making a contract concerning

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[131] THANI ET AL., *supra* note 11, at 68–69; EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 70–71.

[132] *Id.*

[133] THANI ET AL., *supra* note 11, at 68–69; *see generally* Saiful Azhar Rosly & Mahmood Sanusi, *Some Issues of Bay' al-'Inah in Malaysian Islamic Financial Markets*, 16:3 ARAB L.Q. 263 (2001).

[134] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 70–73.

[135] *See id.* at 69–70 (discussing how the structure of a *tawarruq* transaction voids the classical restriction on one entity from acting as agent for both trading parties); OIC Fiqh Academy Issues Fatwa Ruling Tawarruq Is Not Shari'ah-Compliant, http://investhalal.blogspot.com/2009/05/oic-fiqh-academy-issues-fatwa-ruling.html (May 20, 2009, 16:09 PST).

[136] EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 70–73.

[137] THANI ET AL., *supra* note 11, at 44–49.

[138] *Id.*

something that he or she does not yet own.[139] However, the Maliki believe that the prohibition against such contractual uncertainty does not apply to gifts, which means that the financier can make an enforceable commitment to gratuitously remit the object to the borrower at the end of the *ijara* term.[140] This opinion has been adopted throughout the Muslim world, including in the non-Maliki regions of Malaysia and the Arabian peninsula, and *ijara* has become an increasingly popular financing arrangement.[141]

The legality of the *bai' bithaman ajil*, *murabaha*, *ijara*, and especially the *tawarruq* and *bai' al-'ina* in some regions reveals a surprising permissiveness in Islam towards interest-avoiding schemes. Many Muslim scholars lament the proliferation of these financing products, characterizing them as departures from the ideals of Islamic finance.[142] However, the formalist and ordering attitudes of Islamic law leave these critics with little recourse. Ultimately, a broad consensus has developed through the Muslim world that these transactions *do* comply with *sharia*—in letter if not in spirit—and are allowed by the Quranic principle that "Allah has made trade lawful."[143]

B. Halakha

As predicted in the hypotheses, Talmudic law does not recognize the simpler interest-avoiding transactions, but it does accept the more complex ones. Rabbinic legislation banned a wide number of credit-extending scenarios as *ribbit d'rabbanan*, which makes most of the common transactions in Islamic finance unacceptable. As a general rule, a merchant may not charge different prices for cash, credit, or advance payment sales.[144] The lack of a differential between cash and credit prices effectively makes the *bai' bithaman ajil*, *murabaha*, *tawarruq*, and *bai' al-'ina*, as currently practiced, ineffective as interest-avoiding vehicles under Talmudic law.[145]

Halakha and *sharia* both allow rental contracts.[146] However, the *ijara* contract used in Islamic banking has dubious legality in *halakha* due to the promise to remit the item to the borrower upon the conclusion of the

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[139] *Id.* at 48–49.

[140] ALY KHORSHID, ISLAMIC INSURANCE: A MODERN APPROACH TO ISLAMIC BANKING 40 (2004).

[141] THANI ET AL., *supra* note 11, at 44–46.

[142] *See, e.g.*, Tarek El Diwany, *Islamic Banking Isn't Islamic*, ISLAMIC-FINANCE.COM, June 2003, http://www.islamic-finance.com/item100_f.htm.

[143] *Quran* 2:275.

[144] REISMAN, *supra* note 43, at 114–15.

[145] It also, incidentally, forbids the "2/10 net 30" billing practice common in the United States. *Id.* at 120–23.

[146] Under the *halakha*, if a person borrows a certain amount of cash purely for the purposes of display, the lender can demand rent provided that the identical cash is returned. *Id.* at 195–96.

contract.[147] One possible solution raised by Talmudic jurists is a mixed sale-lease agreement, in which the financier purchases the object in question and sells it back, fraction-by-fraction, to the purchaser.[148] Under this scenario, the financier can properly charge the co-owner rent for use of its remaining fraction.[149] The result is very similar to *ijara*, but with an added layer of complexity brought on by the introduction of co-ownership and mixed purchase-rental payments.[150]

Islamic banking also makes considerable use of the *mudaraba* contract, a form of equity partnership in which the financier provides capital to an entrepreneur to use for a business, with profits shared according to a fixed percentage (typically 50 percent each).[151] Under Jewish law, this kind of contract is called *palga milveh u'palga pikadon* ("PMUP") and is characterized as a 50 percent investment from the financier and 50 percent loan to the entrepreneur.[152] However, because a lender-creditor relationship exists between the two parties, the entrepreneur cannot provide any free services to the financier, including managing his or her money, without violating the law of *ribbit*.[153] Consequently, the PMUP only passes muster if the financier pays the managing partner a salary, usually fixed at one dollar,[154] which is an additional level of complexity not required by *sharia*.[155]

Under *halakha*, a PMUP contract cannot guarantee the level of profit or even repayment of the principal.[156] However, the parties can include a clause stating the level of expected profit, and allow the recipient of the funds to return that amount of profit to the financier in lieu of the actual net income.[157] If the recipient of the funds wishes to claim a loss or a lesser level of profit, the PMUP may require him to take a solemn oath before a Jewish court or the entire synagogue, and/or produce a highly impractical number of

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[147] *Id.* at 245.

[148] *Id.* at 248–50.

[149] REISMAN, *supra* note 43, at 248–50.

[150] A very similar kind of transaction, the *ijara thumma bai'*, also exists in Islamic finance. THANI ET AL., *supra* note 11, at 48–49.

[151] *See id.* at 49–52; EL-GAMAL, ISLAMIC FINANCE, *supra* note 2, at 120–23.

[152] REISMAN, *supra* note 43, at 379, 391.

[153] *Id.* at 383–84, 394.

[154] *Id.* at 379-80.

[155] *Id.* The entrepreneur's "salary" possibly runs afoul of the rule in the Ottoman civil code ("Mejelle") that limits the entrepreneur's compensation to profits from the venture. *See* THE MEJELLE: BEING AN ENGLISH TRANSLATION OF *MAJALLAH EL-AHKAM-I-ADLIYA* AND A COMPLETE CODE OF ISLAMIC CIVIL LAW 236 (C.R. Tyser et al. trans., 1967) (discussing section 1426 of the Mejelle).

[156] REISMAN, *supra* note 43, at 391–92.

[157] *Id.* at 390, 392–93.

witnesses to testify to the loss.[158] Since Orthodox Jews traditionally refrain from taking solemn oaths for fear of inadvertently taking the Lord's name in vain, the "oath clause" effectively converts the PMUP into a fixed-return contract known as the *heter iska*.[159] The *heter iska*, in various forms, allows Jews to engage in a number of interest-bearing and interest-like transactions, and has become essentially an all-purpose vehicle for circumventing the prohibition of *ribbit*.[160] The proliferation of the *heter iska* reveals how Jewish law, a formalist and actualizing tradition, takes a permissive approach to interest-avoiding transactions once they reach a certain level of complexity.

C. *Western Law*

As predicted in the hypotheses, both common and civil law have developed a contextual approach to deciding whether a particular ensemble of transactions effectively converts interest into non-interest. Whether a particular payment constitutes interest depends less on the precise legal form of the transaction, and more on the relationship between the parties, their underlying intentions, and the objectives of the regulation that the transaction circumvents.

Under common law, the contextual approach dates back to the Elizabethan-era case of *Tanfield v. Finch*,[161] where Chief Baron Bell explained that a scheme such as a long-term lease, an annuity purchase, or a sale of land rents constitutes "usury" when the parties had previously communicated and formed a common intent to make a loan.[162] Subsequent jurisprudence applied this approach to a variety of other forms of interest-avoiding transactions, ultimately concluding that interest is created by the intent of the parties, not the formal structure of the contracts.[163]

This focus on intent remains in the common law today, as illustrated by *Boerner v. Colwell Co.*,[164] the leading case on the issue of credit sales, where the California Supreme Court observed that:

> Although the constitutional and statutory provisions dealing with usury speak only in terms of a "loan" or a "forbearance"

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[158] *Id.*

[159] *Id.*

[160] Visser & McIntosh, *supra* note 9, at 177–78.

[161] Tanfield v. Finch, (1583) 78 Eng. Rep. 293 (K.B.).

[162] JONES, *supra* note 21, at 119.

[163] *Id.* at 120–21.

[164] Boerner v. Colwell Co., 577 P.2d 200 (Cal. 1978); *see also* Kunert v. Mission Fin. Services Co., 110 Cal. App. 4th 242, 249 (2003) (noting that loans are subject to statutory and constitutional restrictions on usury).

> of money or other things of value, the courts, alert to the resourcefulness of some lenders in fashioning transactions designed to evade the usury law, have looked to the substance rather than the form of such transactions in assessing their effect and validity, and in many cases have struck down as usurious arrangements bearing little facial resemblance to what is normally thought of as a "loan" or a "forbearance" of money. In all such cases the issue is whether or not the bargain of the parties, assessed in light of all the circumstances and with a view to substance rather than form, has as its true object the hire of money at an excessive rate of interest. The existence of the requisite intent is always a question of fact.[165]

The Appellate Division of the New York Supreme Court took a similar approach in the seminal case of *Archer Motor Co. v. Relin*, which involved a service charge appended to a credit sale of an automobile.[166] The Court unanimously concluded that:

> It has been broadly stated that: "A sale of merchandise on credit [is one] to which the usury laws have no application." However, it is doubtless true that, if a pretended sale of goods is made the underlying scheme for loaning money upon usury, the courts will be vigilant to judge the transaction by its real character rather than by the form and color which the parties have seen fit to give it.[167]

Canadian courts also take a contextual approach when analyzing interest-like transactions. For income tax purposes, for example, whether a credit sale mark-up constitutes interest depends upon the relationship between the parties and prevailing economic conditions. The Supreme Court of Canada demonstrated this principle in *Minister of National Revenue v. Groulx*, finding that a long-term credit sale made by a sophisticated businessman at a price considerably above market value included an implicit interest component.[168] The Canada Revenue Agency has attempted to apply a similarly contextual approach to *ijara*-like sale-and-leaseback contracts:

> A sale-leaseback agreement involves two separate transactions; the sale of the property to the prospective lessor and the subsequent lease of the property to the original owner. In respect of such an agreement, the Department's

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[165] *Boerner*, 577 P.2d at 204–05 (internal citations omitted).

[166] Archer Motor Co. v. Relin, 8 N.Y.S.2d 469, 470 (N.Y. App. Div. 1938).

[167] *Id.* (footnotes omitted).

[168] Minister of Nat'l Revenue v. Groulx, [1966] Ex. C.R. 447 (Can.).

> principal concern is in ensuring that repayments of what are in substance borrowed funds are not being charged against income as rent. Where it is apparent that the true intent of the parties is that the lessee borrow money on the security of property, the agreement is in substance a loan arrangement. Such an intent is strongly indicated where the sale price of the property is substantially different from its fair market value . . . . Where a sale-leaseback agreement is determined to be a loan arrangement, a sale of the property is considered not to have taken place and the lessor and lessee are considered to be a lender and a borrower respectively with the payments being dealt with on account of principal and interest. The total amount of interest is readily ascertainable by computing the difference between the amount advanced and the total to be repaid. [169]

One particularly ironic illustration of Western law's contextual approach to interest-avoiding transactions appears in *Dato' Haji Nik Mahmud bin Daud v. Bank Islam Malaysia Berhad.*[170] The case originated in Malaysia, a common-law country with a predominantly Muslim population and a large, federally-regulated Islamic banking industry.[171] *Bin Daud* involved a Malay developer who engaged in a *bai' bithaman ajil* financing transaction with an Islamic Bank; he sold his land for RM 520 000 and immediately repurchased it for RM 629 200 on credit.[172] The purported land sale, however, violated the Kelantan Malay Reservation Enactment,[173] which effectively forbids ethnic Malays from selling their land to non-Malays. The Kuala Lumpur Court of Appeal unanimously upheld the trial court decision that *bai' bithaman ajil* did not violate the land reservation statute, since the transaction did not involve any true transfer of land.[174] In the eyes of the court, the transaction constituted an interest-bearing debt for the purposes of land law, but a non-interest-bearing transaction for banking law.[175]

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[169] Canada Customs & Revenue Agency, Interpretation Bulletin IT-233R, "Lease-Option Agreements; Sale-Leaseback Agreements" (Feb. 11, 1983), *available at* http://www.cra-arc.gc.ca/formspubs/prioryear/it233r/it233r-e.pdf. The Agency withdrew the bulletin on June 14, 2001; since then, the status of such transactions remains unclear. *See* CANADA CUSTOMS & REVENUE AGENCY, INCOME TAX TECHNICAL NEWS: NO. 21 (2001), *available at* http://www.cra-arc.gc.ca/E/pub/tp/itnews-21/itnews-21-lp-e.pdf.

[170] Dato' Haji Nik Mahmud bin Daud v. Bank Islam Malaysia Berhad, [1996] 4 M.L.J. 295 (Malay.).

[171] *See generally* THANI ET AL., *supra* note 11, at 1.

[172] *Bin Daud*, 4 M.L.J. at 295.

[173] *Id.* at 302. (discussing the Kelantan Malay Reservation Enactment, 1930, § 7(i)).

[174] *Id.* at 296, 304.

[175] *See id.* at 302.

Civil law jurisdictions also have featured considerable flexibility when applying laws concerning "interest." Civil law jurists have long recognized that interest regulation seeks to prevent forms of economic exploitation. As early as the 12th and 13th Centuries, France saw various legislative (and, more rarely, judicial) initiatives against "usurious" sale and rental contracts.[176] The modern civil codes of both Germany[177] and Quebec[178] have subsumed interest regulation—under broader rules concerning "good morals" and "lesion", respectively—making the question of whether a particular payment constitutes interest virtually irrelevant.[179]

A recent Quebec case, *Yaya c. Pétrement (Cregesmo)*,[180] illustrates the contextual approach to the characterization of financing transactions. The case involved a man who sold his car for C$2500 to a finance company and rented it back for C$175 a week over one year.[181] Typically, a rental contract is not considered a loan under Quebec law, and judges reviewing exploitative rental contracts have typically referred to code provisions concerning abusive clauses in contracts of adhesion.[182] In *Yaya*, however, Justice Amyot declared, without any elaboration, "Il ne fait aucun doute, dans l'esprit du Tribunal, qu'il s'agit d'abord et avant tout d'un contrat de prêt d'argent assorti de garantie et non simplement d'un contrat de location de véhicule."[183] He then went on to declare the contract null on several grounds, including the

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[176] FR. OLIVIER-MARTIN, HISTOIRE DU DROIT FRANÇAIS DES ORIGINES À LA RÉVOLUTION 279–80 (2000).

[177] Bürgerliches Gesetzbuch [BGB] [Civil Code] Aug. 18, 1896, Reichsgesetzblatt [RGBl] 195, as amended, § 138, ¶ 2; *see also* BASIL MARKENSINIS ET AL., THE GERMAN LAW OF CONTRACT: A COMPARATIVE TREATISE 250–53 (2d ed. 2006).

[178] QUÉBEC, DEP'T OF JUSTICE, COMMENTAIRES DU MINISTRE DE LA JUSTICE: LE CODE CIVIL DU QUÉBEC ART. 2332 (1993); Me Louise Poudrier-LeBel, *Les Règles Générales du Contrat de Prêt D'Argent*, *in* 5 OBLIGATIONS ET CONTRATS, COLLECTION DE DROIT 281, 281–85 (2007). For an older French perspective, see COULAZOU, *supra* note 15, at 30–32.

[179] *See, e.g.*, François Tôth, *Commentaire sur la Décision Option Consommateurs c. Service aux Marchands Détaillants Limitée* (Household Finance)—*Frais de Retard et Pénalité dans le Contrat de Crédit Soumis à la Loi sur la Protection du Consommateur* [Commentaries on the Decision Option Consumers v. Service to Limited Retailers (Household Finance)—Expenses and Penalties for Delay in Credit Contracts Under the Consumer-Protection Law], REPÈRES, Aug. 2003, § III(D), http://www.dcl.editionsyvonblais.com/app/dclrejb/dclrejb/dcl_welcome? productname=dcl.

[180] Yaya c. Pétrement (Cregesmo), [2006] J.E. 2007–242 (ct. Quebec) (Can.).

[181] *Id.* para. 11–13.

[182] *See, e.g.*, Location Tiffany Leasing Inc. c. 3088–6022 Quebec Inc., [1998] REJB 1998-07430 (ct. Quebec) (Can.).

[183] "There is no doubt, in the opinion of the Court, that this is first and foremost a contract to lend money with security and not simply a car rental agreement." [translation by author] *Yaya*, JE 2007-242, para. 31.

criminally usurious rate of interest[184] and the fact that the lender issued the "loan" without a provincial license.[185]

In *sharia* and *halakha*, a particular transaction either creates *riba/ribbit* or not, without reference to the broader contextual factors such as the subjective intentions of the parties. In Western law, in contrast, whether a particular transaction creates interest remains largely a question of fact that judges can appraise in light of a broad range of factors, of which the formalities of the transaction constitute but one part. This contextual approach is consistent with Western law's ordering vocation and substantive methods of legal interpretation.

D. GAAP

As predicted in the hypotheses, GAAP demonstrates the least willingness to accept interest-avoiding transactions at face value. Numerous accounting standards, both international ("IAS" Standards) and American ("SFAS" Standards), mandate that financing transactions appear on financial statements as interest-bearing debt regardless of their legal form. This principle has found a particularly strong expression in IAS 32,[186] which mandates the use of the effective interest accounting method for any "contractual right to receive cash or another financial asset from another entity."[187] Interest-avoiding transactions that make use of long-term credit differentials, such as the *murabaha* and *tawarruq*, all potentially fall within the scope of this provision.

Other standards address specific types of transactions. For example, IAS 17[188] and SFAS 13[189] deal with leases, and both require treating a purported lease as an interest-including credit sale when it "transfers substantially all the risks and rewards incidental to ownership of an asset."[190] The *ijara* contract, since it transfers ownership of the asset at the end of the term, would therefore qualify under both standards as a lease requiring capitalization.[191] Sale-and-repurchase arrangements, like the *bai al-'ina*, fall

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[184] *Id.* paras. 34, 40.

[185] *Id.* paras. 36–39.

[186] IAS Plus: IAS 32 Financial Instruments Presentation, http://www.iasplus.com/standard/ias32.htm (last visited Jan. 27, 2010) [hereinafter IAS 32].

[187] COOK ET AL., *supra* note 54, at 348.

[188] IAS Plus: IAS 17, Leases, http://www.iasplus.com/standard/ias17.htm (last visited Jan. 27, 2010) [hereinafter IAS 17].

[189] *See* FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FIN. ACCOUNTING STANDARDS NO. 13: ACCOUNTING FOR LEASES (1976), *available at:* http://www.fasb.org/pdf/fas13.pdf.

[190] IAS 17, *supra* note 188, *cited in* COOK ET AL, *supra* note 54, at 458.

[191] *Id.* at 462–63.

within IAS 18[192] and SFAS 49,[193] which both require accounting for the transaction as an interest-bearing loan rather than a sale.[194] Furthermore, IAS 32[195] and SFAS 150[196] pertain to the distinction between debt and equity, and require that, "[i]n determining the classification between equity and liabilities substance takes precedence over legal form."[197] Interest-avoiding transactions that purport to be equity investments—like the *heter iska* or the *mudaraba* (in cases where the "profits" are guaranteed)—must therefore appear on the balance sheet as interest-bearing debt, since they unconditionally oblige the transfer of funds from one party to the other.[198]

Ultimately, GAAP recognizes virtually none of the interest-avoiding transactions that have become commonplace in *sharia* or *halakha*. GAAP's tendency to look through interest-avoiding transactions meshes with its substantive interpretive method and actualizing vocation. This systematic non-recognition has no doubt served as an important driver for the development of alternative accounting standards seen as "more appropriate" for Islamic financial institutions.[199]

V. CONCLUSION

Debt can lead to all sorts of exploitation and misery, and thus virtually every legal order has promulgated rules that regulate interest rates and other aspects of the creditor-debtor relationship. On the other hand, credit forms an integral part of even the most basic economy, raising the efficiency of production and consumption. It hardly seems surprising, therefore, that *sharia*, *halakha*, common law, civil law, and GAAP have all developed legal frameworks and devices that facilitate lending in spite of the restrictive regulations. These mechanisms produce largely the same results—Alex gets his loan, Ahmed his *bai' bithaman ajil*, Aryeh his *heter iska*,[200] and all three

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[192] IAS Plus: IAS 18, Revenue, http://www.iasplus.com/standard/ias18.htm (last visited Jan. 27, 2010).

[193] *See* FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FIN. ACCOUNTING STANDARDS NO. 49: ACCOUNTING FOR PRODUCT FINANCING ARRANGEMENTS (1981), *available at* http://www.fasb.org/pdf/fas49.pdf.

[194] *Id.* at 7–8; COOK ET AL, *supra* note 54, at 568–69.

[195] IAS 32, *supra* note 186.

[196] *See* FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FIN. ACCOUNTING STANDARDS NO. 49: ACCOUNTING FOR CERTAIN FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY (2003), *available at* http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias18_en.pdf.

[197] COOK ET AL., *supra* note 54, at 378.

[198] *Id.* at 378–79.

[199] THANI ET AL., *supra* note 11, at 22–25.

[200] The use of the *heter iska* for home purchases is controversial in Jewish law, since it strains the fiction to the limit. REISMAN, *supra* note 43, at 249.

men settle into their new homes and have to pay $105,000 next year. However, the actual tools developed in the various traditions to characterize the transaction are quite different. This Article has sought to illustrate that these differences do not stem from chance, but instead reveal fundamental differences in attitudes on the nature of law and how it should be interpreted. In the case of *sharia*, the relatively permissive approach to interest-avoiding transactions reflects a formalist approach to legal interpretation and an essentially ordering vocation of law.

Using this typology, further research can develop and test similar hypotheses about other thorny challenges faced by different legal traditions. Possibly fruitful topics include the role of hardship as grounds to void a contract, various forms of unjust enrichment claims, or issues involving matrimonial property. It may also prove useful to apply the taxonomy to different currents within each legal tradition. For example, within *sharia*, the Maliki tend to take a more substantive approach to legal interpretation, and the Shafi'i a more formalist view. These differences can engender different solutions to particular legal problems.

Ultimately, the exploration of the underlying attitudes that give rise to legal differences can facilitate more productive dialogue among and between the different cultures and traditions, both by identifying the points of commonality and by better understanding the sources of difference. This particular study of interest-avoiding transactions reveals that *sharia*, as a formalist and ordering tradition, is not as different from Western law as it often is portrayed. Western law itself has gone through its formalist periods, aspects of which remain today, and recognition of the underlying commonalities between *sharia* and Western law can only help bridge the gap between these legal traditions and the societies that adhere to them.