



التجارة الرابحة

The Basic  
**PRINCIPLES**  
of a  
**PARTNERSHIP**





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# The Basic Principles of a Partnership

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## Amirul Mumineen Maulana Ali b. Abi Talib <sup>AS</sup> states

الفقه ثم المتجر فان من باع واشترى ولم يسأل عن حرام  
ولا حلال امرطم في الربا ثم امرطم

*[understand] the laws of shariat, then engage in commerce. A person who buys or sells without first asking about halal and haram, will, inevitably, become mired in interest and remain entrenched in it.*



Before engaging in any economic activity, a Mumin needs to first **understand the principles of shariat mohammediyah**. This document outlines the guiding principles of partnerships based on the tenets and canons found in Baab al-Buyoo´ of Da´aim al-Islam (Vol. 2) and Mukhtasar al-Aathaar (Vol. 2), both composed by al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup> and from the various mandates of al-Dai al-Ajal Syedna Mohammed Burhanuddin <sup>RA</sup> and al-Dai al-Ajal Syedna Mufaddal Saifuddin <sup>TUS</sup> on ethical behavior in economic activities.

The intent behind these guidelines is for readers to use them as a basis to form and maintain valid and ethical partnerships founded on consent, respect, and transparency between all parties involved and to draft shariat compliant written agreements.

# Partnerships According To Shariat Mohammediyah

A partnership is an agreement formed between two or more individuals to pool their money, skills or other resources with the intent to share in the profit and loss of a particular venture.

There are two types of partnerships described in Dawat texts.

## 1. Mushaarakat

A partnership that involves the investment of capital by all partners, with equity (ownership) proportional to the amount of capital invested by the partners.<sup>1</sup>

## 2. Mudaarabat

A partnership where one party provides capital to another non-investing party for a particular venture. Both parties share in the profit earned from the venture.<sup>2</sup> Loss, however, is borne on the capital investment only.

*Note: Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, in Daaim al-Islam vol. 2 (Zikr al-Shirkat), states that the ideal form of a partnership is the when two men agree to become partners. They both invest equal amounts of capital, and that capital is combined so that it becomes one, to the extent that [the original capital] one cannot be distinguished one from the other. They may buy and sell in any line of trade; whatever they earn in profit is distributed proportionally amongst them and whatever the loss incurred is upon them equally. No one partner can buy or sell without the other partner's consent and unless an agreement has been made for that.<sup>3</sup>*

<sup>1</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, Mukhtasar al-Aathaar vol. 2 (Mumbai: Aljamea-tus-Saifiyah Press, 1426 AH/2005 AD), 89

<sup>2</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, Da'aim al-Islam vol. 2 (Beirut: Mu'assasah al-Noor Press, 1426 AH/2005 AD), 48

<sup>3</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, Da'aim al-Islam vol. 2, 48

# Partners and Mutual Agreement

- 1.1. A partnership is the relation between persons by contract who have agreed to share in the profits and loss of a business carried on by all or any of them acting for all. The partnership refers to the **relationship** of all partners **collectively**.
- 1.2. All decisions regarding the formation of a partnership and operation of the firm or venture should be made by **mutual agreement** and **free will**.<sup>4</sup> Parties entering into a partnership should be baaligh and of sound mind.

Note: A partnership is formed by contract or agreement only and the relation of partnership arises from contract and not from status. A family member who is not by agreement a member of the firm is not considered a partner and does not share in the rights and authorities of partners.

*Example: Fakhri Fasteners, a small-scale manufacturer of precision safety valves for 25 years, is owned by two cousins, Taher and Shabbar. Taher's younger brother Husain also works as part of the product development division in the firm. Although Husain has been working for the firm for 7 years, no agreement has been made formally by Shabbar and Taher to add Husain as a partner to the firm. Until a formal agreement is made, Husain is still considered an employee of the firm and doesn't share any of the rights of the partners, including profit-sharing or taking key business decisions reserved for partners.*

- 1.3. Partners should maintain a **good working relationship** with each other and maintain trust and transparency during the partnership.

<sup>4</sup> Al-Dai al-Ajal Syedna Aali Qadr Mufaddal Saifuddin <sup>TUS</sup>, Ashara Mubarak M6 1438 H

## Formation, Raza and Registration

- 2.1. As best practice, partners should discuss and present all information regarding the nature of the venture **prior to formation**.
- Note: Preparing a feasibility study or a business plan can serve this purpose.*
- 2.2. To **maintain a healthy working relationship** and **avoid unnecessary disputes**, a **partnership agreement** between partners should be drafted describing the partners, the firm, the venture and all the terms and conditions agreed upon. At minimum, the draft could include the following:
1. Name of Partners, Name of Firm, and The Type of Venture
  2. Capital Investment by Partners
  3. Profit-Sharing Ratios
  4. Working Terms
  5. Dissolution and Dispute Resolution Terms
- 2.3. **Raza Mubarak** (permission) should be obtained from the **53<sup>rd</sup> al-Dai al-Mutlaq** before engaging in any economic activity, including the forming of partnerships.<sup>5</sup>
- 2.4. According to the law of the land, partnerships should be registered with the concerned government authorities.

<sup>5</sup> Al-Dai al-Ajal Syedna Aali Qadr Mufaddal Saifuddin <sup>TUS</sup>, Ziyaafat Jam'iyat al-Tujjaar (Dubai)



## Permissible Practices

- 3.1. Any business venture is **only valid** if the partners involved plan to do a business free from any sort of riba (interest), deception, dishonesty, fraud, gambling, or any other unethical elements.<sup>6</sup>
- 3.2. The partnership should not directly or indirectly lead to the physical, financial, social or spiritual harm of either an individual or society.<sup>7</sup>
- 3.3. All conditions of the partnership should be **within the confines** of **al-Quran al-Majeed** and **Shariat**.<sup>8</sup>
- 3.4. The partnership should **adhere** to the governing laws of the nation in which it operates.<sup>9</sup>

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<sup>6</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, *Da'aim al-Islam* vol. 2, 5-19

<sup>7</sup> Ibid., 49

<sup>8</sup> Ibid.

<sup>9</sup> Al-Dai al-Ajal Syedna Aali Qadr Mufaddal Saifuddin <sup>TUS</sup>, *Ziyaafat Jam' iyyat al-Tujjaar* (Dubai)

# Share of Ownership And Capital Investment

- 4.1. The amount of Initial capital contributed by each partner should be **clearly specified** at the time of formation.<sup>10</sup>
- 4.2. Any capital invested into a partnership is owned and **utilized jointly** by the partnership without bias or classification of specific ownership.<sup>11</sup>

*Note: An example for clarification is the mixing of water, where after mixing, all the components become one without distinction.*

- 4.3. Debt of any kind cannot be converted into an investment for partnership. The debt must be repaid as is.<sup>12</sup>

*Example: Huzefa has taken Qardan Hasana from Adnan of Rs. 350,000. Huzefa uses the Qardan and decides to start a small consultancy firm in the name of Noor Consultancy. A few months later, Huzefa's company is very profitable so Adnan tells Huzefa to convert the Qardan into an investment with profit-sharing of 30%. This is prohibited and Huzefa must repay the Qardan of Rs. 350,000 to Adnan before he can Invest with him*

- 4.4. The ratio or share of ownership for each partner is **proportional** to their capital investment in the partnership.
- 4.5. There should be an agreement on whether partners may invest additional capital, withdraw capital, and the limits to which they may do so.
- 4.6. The amount of capital added or subtracted by partners should always be **specified** and **recorded** since it could change the ratio or share of ownership of each partner.

*Note: When capital is added or subtracted, it is prudent to also discuss any changes in the profit sharing ratio if it applies.*

<sup>10</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, *Mukhtasar al-Aathaar* vol. 2, 89

<sup>11</sup> Ibid., 48

<sup>12</sup> Ibid., 93

# Sharing of Profit and Loss

- 5.1. **Profit may be distributed amongst partners according to any ratio agreed upon.** It does not need to match the investment or ownership ratio of the partners.<sup>13</sup>
- Example: Mohammed invests Rs. 30,000 and Shabbir invests Rs. 70,000 in starting a new hardware shop named Raj Enterprises - so the investment ratio is 30:70. Mohammed also gives more time to running the firm so both partners agree to a profit sharing ratio of 50:50.*
- 5.2. It is prohibited for any partner to receive a guaranteed or fixed profit: a profit that has no connection to the profitability of the venture. A fixed or guaranteed profit is considered a form of ribaa' (interest).<sup>14</sup>
- Example: Ahmed invests Rs. 100,000 into a paper manufacturing unit named Babji Papers - owned and operated by Idris. Both partners agree that Ahmed will receive a fixed return of Rs. 10,000 per month, regardless of the profit and loss posted by the unit itself. This type of return is strictly prohibited and the agreement is invalid.*
- 5.3. **Profit earned from the venture should be calculated first and then distributed among partners according to the profit-sharing ratio agreed upon.**
- Example: After reviewing the profit and loss of Raj Enterprises at the end of the year, the partners find that the firm has earned a net profit of Rs. 200,000. Based on their profit sharing ratio of 50:50, both partners are eligible to draw profits of upto Rs. 100,000 each.*
- 5.4. **If the venture incurs a loss, the partners will bear the loss in proportion to their capital investments or ownership ratio only.**<sup>15</sup>
- Note: In the case where only one partner has invested, the investing partner bears the loss totally because loss is only borne on capital investment.*<sup>16</sup> *However, the non-investing partner will not be compensated for his efforts.*
- 5.5. If a partner violates the terms and conditions stipulated in the partnership contract by acting irresponsibly or unethically, he or she is responsible for any loss incurred.<sup>17</sup>

<sup>13</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, *Da'aim al-Islam* vol. 2, 49

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

## Liabilities and Debt

- 6.1. The partnership is **liable** to **repay** any and all debts or liabilities accumulated by the firm during the normal course of operating the venture.<sup>18</sup>
- 6.2. Even after death, a person is obligated and liable to repay all his debts from his estate.<sup>19</sup>

Note: Debts are repaid from inheritance. However, it is mandatory for the claimant to provide evidence of any such debt first.

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<sup>18</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman<sup>RA</sup>, *Mukhtasar al-Aathaar* vol. 2, 92-93

<sup>19</sup> Ibid.

# Rights and Decision Making

- 7.1. All decisions in the course of operating the business venture should be by **mutual consent** of all the partners or based on specific stipulations made in the partnership agreement.<sup>20</sup>
- 7.2. As best practice, the partners should establish beforehand a detailed **division of work** and **responsibilities** regarding the management of the venture and describe it in the agreement.
- 7.3. In the case of a *mudaarabat*, the investing partner's consent must be taken in decisions that affect the overall strategy of the venture or in the case of investment decisions that have a significant financial implication.

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<sup>20</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, *Mukhtasar al-Aathar* vol. 2, 89-90

# Dissolution of the Partnership

- 8.1. A partnership is dissolved if:
- Partner dies, resigns, retires, or at will, notifies all the partners of his/her intention to dissolve the partnership.<sup>21</sup>
  - The purpose or time period for which the partnership was formed is completed.
- 8.2. At the end of a partnership, all the partners should receive their share of the capital at **fair market value**. As best practice, fair market value *can be* derived using generally accepted accounting principles (GAAP).
- 8.3. At the time of dissolution, if a third party owes the firm, then the asset (in the form of cash or kind) must first be recovered and tallied with the capital or assets of the firm and then divided proportionally amongst all the partners. The asset cannot be divided before recovery.

*Example: Brothers Huzefa and Yusuf own a firm in the international trade of dry fruits under the name of Qadir's Cashews & Dry Fruits. Two of their major clients in India have simultaneously defaulted on a payment (supposed to make at delivery) for a large shipment of Almonds that came in from the U.S. The partners had blocked a majority of their capital in the shipment and the clients are asking for 6 months to make the payment. The partners decide it is no longer feasible to run the firm. Since they are dissolving the partnership, Huzefa suggests that whatever is recovered from the first client belongs to him and whatever is recovered from the second client belongs to Yusuf. This is prohibited and all the payments recovered from both clients should be distributed to both of them. Whatever is recovered from capital should be distributed according to their ownership and anything recovered from profits according to their profit-sharing ratio.*

<sup>21</sup> Al-Dai al-Ajal Syedna al-Qadi al-Noman <sup>RA</sup>, *Mukhtasar al-Aathaar* vol. 2, 92

## Dispute Resolution

- 9.1. If a dispute arises between partners, they should first work to resolve their dispute amicably **amongst themselves**.
- 9.2. In the case of an unresolved dispute, partners should **seek resolution** from the **office of His Holiness Dr. Syedna Mufaddal Saifuddin <sup>TUS</sup>** or a **person appointed** by him acting as a mediator. All partners must **honour** any decisions taken during the course of mediation as final and binding. The concerned parties should not seek resolution from the courts or any other entity.



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