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INSOLVENCY AND BANKRUPTCY BASED ON ISLAMIC PRINCIPLES WITHIN CHINA – AN DATA-DRIVEN ANALYSIS AND FRAMEWORK

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ABSTRACT

Objective: The objective of the article is to provide a solid outline how Islamic bankruptcy principles can be integrated into the Chinese legal system. Islamic bankruptcy law and Islamic finance have taken on a growing role in modern economies, with several governments aiming to align the economic system with Islamic principles in addition to solving some of the shortcomings of existing financial regulations related to bankruptcies. China has, within the last 40 years, become a major economy with significant development of its legal system.

Theoretical framework: For the theoretical framework we utilized a comparative legal analysis framework for the integration, given that Islam emphasizes the importance that there should be no distinction between balance sheet insolvency and cashflow insolvency, as well as the importance of personal responsibility for the debts incurred.

Method: For the method, we deployed a comparative analysis of the Islamic and Chinese bankruptcy legal framework.

Results and conclusion: The article has presented a solid outline of the Islamic and Chinese bankruptcy laws and how Islamic principles can be integrated into the Chinese legal system. The arising system in the form of either a separate legal system or one integrating these principles into the existing bankruptcy regulations can significantly strengthen debtor responsibility and recovery rates, as well as encourage fairer business practices.

Implications of the research: The research provides some critical insights into how Islamic Finance may be adjusted to support and reduce bankruptcy within China, outlining the major benefits of Islamic finance in strengthening the financial system.

Originality/value: The article provides a unique outline of Islamic and Chinese bankruptcy laws and how Islamic principles may be integrated into the Chinese legal system.

Keywords: Bankruptcy Law, Islamic Law, Chinese Bankruptcy Law, Data-Driven Analysis, Bankruptcy Framework.

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INSOLVÊNCIA E FALÊNCIA BASEADAS NOS PRINCÍPIOS ISLÂMICOS NA CHINA - UMA ANÁLISE E UMA ESTRUTURA ORIENTADAS POR DADOS

RESUMO

Objetivo: O objetivo do artigo é fornecer um esboço sólido de como os princípios islâmicos de falência podem ser integrados ao sistema jurídico chinês. A lei islâmica de falências e as finanças islâmicas têm assumido um papel cada vez mais importante nas economias modernas, com vários governos buscando alinhar o sistema econômico aos princípios islâmicos, além de resolver algumas das deficiências das regulamentações financeiras existentes relacionadas a falências. Nos últimos 40 anos, a China se tornou uma grande economia com um desenvolvimento significativo de seu sistema jurídico.

Estrutura teórica: Para a estrutura teórica, utilizamos uma estrutura de análise legal comparativa para a integração, uma vez que o Islã enfatiza a importância de não haver distinção entre insolvência de balanço e insolvência de fluxo de caixa, bem como a importância da responsabilidade pessoal pelas dívidas contraídas.

Método: Para o método, implantamos uma análise comparativa da estrutura jurídica islâmica e chinesa sobre falências.

Resultados e conclusão: O artigo apresentou um esboço sólido das leis de falência islâmicas e chinesas e como os princípios islâmicos podem ser integrados ao sistema jurídico chinês. O sistema resultante, seja na forma de um sistema jurídico separado ou de um sistema que integre esses princípios às normas de falência existentes, pode fortalecer significativamente a responsabilidade do devedor e as taxas de recuperação, além de incentivar práticas comerciais mais justas.

Implicações da pesquisa: A pesquisa fornece alguns insights críticos sobre como as finanças islâmicas podem ser ajustadas para apoiar e reduzir a falência na China, delineando os principais benefícios das finanças islâmicas no fortalecimento do sistema financeiro.

Originalidade/valor: O artigo fornece um esboço exclusivo das leis islâmicas e chinesas sobre falências e como os princípios islâmicos podem ser integrados ao sistema jurídico chinês.

Palavras-chave: Lei de Falências, Lei Islâmica, Lei de Falências Chinesa, Análise Orientada por Dados, Estrutura de Falências.

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1 INTRODUCTION

Insolvencies and bankruptcies are a natural part of any economy, ensuring that resources are best utilized within the economy and ensuring that businesses in distress or those not viable have an exit strategy.

Bankruptcy and insolvency in Islamic law are well covered. The Arabic word *Iflas* refers to bankruptcy and covers both balance sheet insolvency in addition to income or cashflow statement insolvency. In the case of a balance sheet insolvency, the entity's assets are less than the liabilities of the entity. Given the equality of the asset side and the liabilities and stockholder equity, this implies that the stockholder equity has to be negative [1]. The income statement or cashflow insolvency is the situation where the entity does not have sufficient liquidity or monetizable assets to cover the debt that comes due. The associated Arabic word *muflis* refers to a bankrupt entity irrespective of whether it refers to a male or female person or an enterprise. The challenge is that once one becomes a *muflis*, then one either has to fully repay all the debts that are unforgiven or face death.

The main text relating to bankruptcy is the Quranic verse 2:280, which emphasizes that for any person in distress, there should be respite until the person recovers. Furthermore, it

emphasizes that one should not boast about forgiving debt but rather see it as a sign of gratitude. This puts social responsibility and charity at the heart of Islamic law, but given that it is solely a recommendation, it has to be seen in the light of other Quranic verses that compel Muslims to repay debts. Not repaying makes this a sin and not just a legal obligation [2].

This implies that both creditors and debtors are compelled to be honest and ensure fairness in addition to fulfilling their contracts. The prophet emphasized that without a just cause delaying the payment of a debt or an obligation is unjust. Generally speaking, debt is frowned upon for Muslims based on ethical and moral perceptions. Specifically, there have been comments by the prophet that emphasized that one's soul will be suspended with debt and freed only upon the repayment of all debt [3].

2 BANKRUPTCY IN ISLAMIC LAW

There is a strong link between the Islamic law of bankruptcy and the Islamic law of finance. Both of these are tied to social responsibility and equity in terms of economics. This implies that the verse stating that all forms of riba are forbidden immediately follows the verses requiring Muslims to be charitable. Lending and repaying are interlinked with each other as a powerful divine compulsion to be charitable and compassionate. Furthermore, both concepts are affected by the static concept of money being a means of exchange and storage but not having intrinsic value itself [4].

This implies the consistent insurance of fair treatment and the punishment of economic hardship caused the inability of a debtor to fulfil their obligations. Another key part is that Islamic law does not have an equivalence to the discharge of debts within Islamic rule. The main reason for this is that Muslims are supposed to fulfil their obligations and promises and should not rely on charity or the benevolence of others unless necessary. Furthermore, this aligns with the lack of interest in money or the increase in the amount of debt over time, so the debtor may have sufficient time available to settle their debt. This implies that the amount of debt, in both real and economic terms, goes down over time, and this requires an individual to pay back the debt at any time in one's life. This requires Muslims to fulfil their promises and obligations to both God and man [5].

This implies that the key tenets of no discharge and social responsibility are the key prescriptive elements in Islamic law and play an important role in its application. The main differences are the time and risk value of money, as well as entity shielding and intangible and non-possessory assets and rights based on which it distinguishes itself.

When looking at the time value of money, then this is commonly measured via the inflation rate that indicates the opportunity cost of having control over and the use of the money within the specified period. On the other hand, the risk value is considerably more complex, consisting of the risk of not being paid back and the risk of not being paid for circumstances that are outside the scope for which it was provided. The latter risk is not considered in Islamic law, given that money may be quantified in the form of either a commodity or be regarded as a universal unit of exchange.

A critical part of Shariah law is that there is no value attached to the ability to utilize money in the meantime. Riba states that it is both unethical and sinful to be paid back the nominal amount. The main difference is that in Islamic finance, the time value of tangible assets is different from that related to inflation alone and consists of the market value of the asset. For example, precious metals as commodities are permitted to increase in value. This supports the harmonization of repayment obligations as well as bankruptcy requirements [6].

Another key aspect is that in Islamic law, the charging of interest on money is rejected. However, entity shielding, as well as forms of limited liability partnerships, have never been

incorporated into Shariah law and corporate forms never developed in Islamic law. Personal and economic activities have to be conducted via direct proprietary ownership or one of the nominated forms of partnership.

Classical Islamic law did not incorporate concepts of non-possessory liens and security interests. Personal possessory liens are solely recognized for ordinary settings, and there is a limitation on real property rights. There is an exception, which focuses on the right to seek recovery of goods from a vendor that was never delivered to a debtor on credit or not paid for [7].

An interesting aspect is that Shariah law incorporated many of the Roman laws that were not present in English common law until the 15th century. Shariah law recognized the usufruct of real property and leaseholds (Ijara) and permitted joint ownership via a partnership.

Muflis are defined as individuals whose debts exceed their assets or whose current expenditures exceed their current revenues. This implies that there is no distinction between balance sheet insolvency and liquidity insolvency. Shariah law does not include the time value of money or intangible assets, as it has the presumption that tangible assets can be readily liquidated. This implies that the assets of the debtor can be used for paying off the debts and so there is no need to distinguish between an asset and cash flow shortfalls. This implies that a debtor transforms into a muflis when the debtor defaults as soon as the creditor request the reimbursement of the debt. The laws are identical for both men and women, as under Islamic law they have the full legal capacity to set up contracts, own property, earn income and inherit. The same applies to businesses and there is no distinction between business bankruptcy and individual bankruptcy. Given that the concept of limited liability corporations did not develop in Islamic law, most business relationships were in the form of partnerships and joint ventures [8, 9].

This implies that the liabilities of a business enterprise are the obligations of the individual owner or partners in the partnership. To address this further, one has to distinguish between the types of partnership structures. The *inan* partnership is the most common form and is a limited investment vehicle that is limited in both duration of the project. This implies that the amount the partner allocates to the partnership is part of the partnership property. All the other assets are not part of the partnership. The partners are not guarantors of each other but are individually liable to third parties. This implies that the third party needs to claim payment directly from the partner they have dealt with. As soon as the partner has paid the claim, the partner is then entitled to seek contributions from the other partner [10].

The partners have no right to take on any debt that exceeds the partnership's agreed assets. If a partner takes one such debt without authorization, then the other partner is not liable for anything above the originally agreed contribution to the partnership fund. In case none of the partners has by their own will undertaken the excess obligations or debt, but the partnership becomes liable for debt above the assets due to unforeseen circumstances (such as the death of a partner), then the other partners will be liable to make up the deficiency per their interests in the partnership. Even though there is the option to distribute profits disproportionately the same is not permitted for liabilities [11, 12].

A mufawada partnership is another type of partnership, where the members of the agency contract are the agents of each other and the guarantors. All the partners have to be equal in terms of capital investment and sharing of profits. All of them are jointly liable for any obligations that are not covered by the mufawada assets [8].

Similar to before, if a liability causes one of the partners to make a payment beyond the personal investment in the mufawada assets, then the partner can seek reimbursement from the other partners. However, the other partners are not liable for criminal acts, wrongful

appropriation and any other purely, personal and non-partnership obligations. Such obligations may arise from marriage and divorce, as well as solely personal guarantees for third parties.

The Mudaraba partnership is amongst the most important partnerships, where one partner may solely provide capital and other material. The mudarba was designed to finance caravans and maritime trade initially, but there are no restrictions on the form of financing utilized. The Mudaraba structure is designed to limit the liability of the investors to the amount invested. The classic mudaraba has the mudarib (manager) that takes the rabb al-mal (investor) funds within the contract and provides a sharing of profits between them for the work performed by the mudarib. The sharing percentage is declared in the contract [4].

The distinction between the mudaraba and a limited partnership is that the investor retains administration on a technical basis yet retains the legal ownership of the capital they have contributed. This creates a construct in Shariah law that has the distinction where the possessor of the asset is not a buyer, lessee or agent. This implies that the liability for loss falls entirely on the investor. However, if the manager exceeds their authority, personality liability is possible. Credit can be taken up to the agreed capital and any further purchases on credit need to have special permissions. Otherwise, they may be personally liable.

A critical part of Islamic law is that all partnerships terminate at the will, death, insanity of a partner or the destruction of the capital. Furthermore, a mufawada partnership is terminated if the partners experience an inequality in interest between them, such as if one partner causes a payment of debts that is greater than another. Furthermore, the receipt of property as part of the partnership in the form of a gift or inheritance may also create an imbalance. Additionally, if one partner becomes insolvent, then he is not permitted to manage or dispose of any of their assets, and this may jeopardize the entire partnership. Hence, the insolvency conditions for an individual are similar to those involving partnerships [13].

For bankruptcy proceedings under Islamic law, this is commenced by the creditor that will request a judge to issue an order to encumber or distrain the debtor. The creditor has the burden to show proof of debt and the due date for the debt. If the judge determines that there are sufficient assets to pay off the debt, the judge will require that the payments have to be completed without distraining the debtor. However, if distraining the debtor is required during the review of the debtor's solvency, this will effectively freeze the debtor’s assets until further order by the court. This issuance of the distraint order is an immediate preliminary injection, which prohibits the debtor from managing, disposing or encumbering the assets.

The four legal consequences that arise from the distraint order are that the rights of the creditors are attached to the property of the debtor and the debtor is prohibited from the disposal or management of the property. Furthermore, the creditor has greater entitlement than the rest of the creditors and the properties of the debtor are liquidated to satisfy the debts [3].

The rights of the creditors are attached to the property, which provides the legal authority for the distraint order. This implies that the person in distraining is regarded as similar to a minor, insane or incapacitated person. The court then appoints a person of trust (rajul thiqah) to deal with the assets and the business affairs of the bankrupt entity. This then will wind down the affairs of the debtor, gather and value all the assets and then liquidate the assets.

If the other debts of the debtor are not due, then the distraint order will not accelerate the due date of the debt. This is based on the argument that the debtor is entitled to additional time to satisfy the debt at the due date. If it is not due, then no inclusion in the bankruptcy proceedings is warranted.

The liquidation is happening in an auction-like setting to ensure that the highest price is realized. Similarly, the rajul thiqah is appointed to take responsibility for the fulfilment of open contracts and the operation of the business as long as the creditors agree.

When it comes to the rights of the creditors, the creditors and debtor have the option to settle the debt. This leads to the withdrawal of the request for the distraint of the debtor. This enables both the debtor and creditor to enter into negotiations and settle the respective claim. Such a settlement resolves any disputes and leads to an end of the litigation. Generally, settlements are highly recommended in Islamic law given the strong focus on social harmony. The settlements can be divided into two separate ones. The first type is the settlement where the debtor denies the claim. This is a situation where the person claims from the debtor a debt, but does not possess cognizable proof of the claim. Such a settlement is based on a compromise to avoid litigation, but the creditor has to ensure that the claim is valid and in good faith. There are discrepancies in terms of whether such claims are accepted [7].

The second type of settlement is one where the creditor claims a right and the debtor admits that he owes the claim. The creditor then accepts less money to settle the claim immediately in the form of a compromise. Whether such a settlement is permissible, depends on the school of law and if the creditor compromises his right to the debt voluntarily, then the settlement should be considered a gift.

The creditors can be classified into receivers, reclamation creditors and lessors. The receiver is the first in line to receive the fees, expenses and other compensation for the management of the bankruptcy proceedings. This includes transportation expenditures, notices to the public, and any other associated expenditures related to the operation of the business. The fees can be forfeited by the receiver if desired.

The reclamation creditors are second in the priority given that their property is possessed by the debtor. The creditor has the right to reclaim the property or can share the property with other creditors. However, to take back the property, five elements have to be satisfied. The first element is that the debtor has to be alive at the time the creditor seeks the return of the property. In case the debtor passes away before the creditor secured the return of the property, then the creditor loses the right to seek the return. Subsequently, all creditors have to join together and share the property proportionate to their respective debts after the liquidation of the property. The second element is that the property has to be in the same state as when the creditor sold it to the debtor. This implies that the property shall be undestroyed or undamaged. The third element is that the property of the creditor is possessed or controlled by the debtor. If the debtor sold, gifted or pledged it, then the creditor solely joins the other creditors in proportion to the debt. The fourth element is that in the case that the debtor paid an instalment or downpayment, then the creditor does not have the entitlement to take back that property. There is the option to pay back the money the creditor has received in return for the property or share proportionally the debt. The fifth element is that if the property value increases or transforms into one with added value, then the creditor either joins existing creditors or takes the property back to the original state [6].

The third in line is lessors where Ijara, a lease, is the primary recognized intangible asset. Hence, if the lessee-debtor becomes bankrupt, then the lessor has the right to annul the contract and retrieve his property provided that the lease date did not commence. If the lease period expired already, then the lessor is similarly a creditor for the unpaid rent. If the lease period commenced but has not expired, then the lessor is not permitted to annul it and the property rights are owned by the lessee-debtor. Furthermore, the usufruct is part of the assets of the bankrupt debtor and the unpaid rent is part of the creditor's demands [10].

The next individual is the secured creditor, where creditors with a secured interest have priority over the specific collateral. Classical Islamic law does not recognize most forms of intangible assets and rights besides the ownership right of the lessor. This recognition enables the distinction between ownership and possessory rights and this has been cemented in the form that the owner of the real property can set up a contract that creates the residual rights of

ownership until the debt is fully repaid. Such a transaction is called the Murabaha. Besides Murabaha and Ijara, the remaining vehicle is the Rahn, which is an actual possessory pledge. Hence, a creditor with pledged collateral has the right to repayment from the collateral [13].

A critical part of Islamic law is that reasonable living expenses and family support are protected from creditors. This includes both clothing, shelter, and food for the wife, children and parents and there should be sufficient capital to survive. The home is generally exempt from creditors to ensure that the family has a place to live.

For the creditor to maintain their rights towards the muflis, they can request the imprisonment of the muflis until all debt is paid, or follow the debtor into the business to determine any assets that can be liquidated and prohibit their travel [8].

Imprisonment or enslaving debtors has a long history, but Islamic law distinguishes between those debtors experiencing a force majeure and those willingly default. Those that can demonstrate that they do not have the funds but are willing to pay their debts, will not be imprisoned. There may be a limited prison sentence to determine the credibility and veracity of the claims of the debtor. The duration of such imprisonment will depend on the judge [5].

The second approach is to permit the creditor to follow the non-paying debtor to determine whether there is any property that may be liquidated. This also implies that the creditor can publicly announce that the debtor owes a debt and may not be a person of trust.

Finally, the debtor may be restricted from travelling outside the town or city to avoid the debtor can dissipate or hiding the assets. Travel may be permitted based on reasonable grounds, such as health, pilgrimage, family obligations and other associated circumstances. If the debtor is not able to pay the debt in question and this can be validly confirmed, then the travel restrictions cease.

3 CHINESE BANKRUPTCY LAW

China has a unified and comprehensive bankruptcy system that covers all types of enterprises., including foreign investment vehicles and state-owned enterprises. China does not have a personal bankruptcy law. The key concepts within bankruptcy law are voluntary and involuntary bankruptcy, as well as an independent administration. Furthermore, the creditors are heavily involved in the administration of the bankruptcy and the restructuring and settlement [14].

Additionally, the principle of extraterritoriality applies to all properties that are outside China in addition to potentially voidable transactions. A major component of the legislation relates to the protection of workers' rights whose claims rank ahead of the unsecured creditors but behind any secured creditors.

The Chinese bankruptcy law consists of 136 articles that are separated into 12 chapters and apply to any type of insolvent enterprise, irrespective of whether it was state or privately owned and includes financial institutions as well as foreign investment enterprises. The law does not apply to individual natural persons. Hence, regulations concerning individual natural persons are separate from the Chinese bankruptcy law, but there is currently no personal bankruptcy law that individuals can refer to. Additionally, the legislation solely applies to PRC entities but also incorporates the debtor's overseas properties [15].

To determine whether bankruptcy is permitted, an insolvency test has to be conducted. Qualifying for bankruptcy, restructuring or settlement requires that the enterprise cannot meet its debt obligations and that the assets do not cover the liabilities or can pay off debts.

To commence the proceedings for bankruptcy, an application in the People's Court where the enterprise is domiciled is needed. This can be initiated by either the creditor or the

debtor. However, if the debtor is a financial institution, then regulatory authorities under the State Council have to file such an application.

As soon as the bankruptcy application is accepted, the court assigns the case to a bankruptcy administrator. The administrator may be a recognized member of any legal, accounting or specialized bankruptcy firm, or has the necessary relevant professional expertise and qualification. Both the selection and the remuneration are determined by the Supreme People's Court [16].

These administrators are reporting to the People's Court and are supervised by the creditors. Specifically, the meeting of the creditors can replace the creditor if needed, or request the removal of the administrator in case the duties are not performed accordingly. Specifically, if the administrator does not act lawfully and impartially, or if the administrator may not perform the duties competently, then there may be a removal [17].

The administrator has several powers and duties such as taking control of the property of the debtor, as well as seals and accounting records, documents and any other material. Furthermore, the administrator investigates and reports the financial status of the debtor. Additionally, decisions are undertaken related to the management and daily expenditure.

The administrator decides also on the continuation or suspension of the business operations of the debtor and the management and disposal of the properties. The administrator also represents the debtor during litigation, arbitration and associated proceedings, and presides over the meeting with creditors and any other necessary functions.

If the administrator fails to act with due diligence and care, then the administrator may be subject to personal liability or face fines. This arises if the administrator caused the loss to a creditor, debtor or any additional third party.

An important part of the claim filing is that the creditors have only a limited period within which they can commence proceedings against the debtor. This period commences with the date of the publication by the People's Court upon the acceptance of the bankruptcy petition and the period has to be between 30 days and three months [18].

These claims include the debts that arise at the date of the application of bankruptcy and any unmatured debts. Additionally, any conditional debts or time-limited debt obligations, and any claims that arise from pending litigation and arbitration. Finally, indemnity obligations and damages under a contract are also included, in addition to the debt owned by joint creditors.

The creditors have the right to get information and participate in the process through creditors' meetings and committees for creditors. This entitles the creditor to both attend and vote in the meeting. This requires that the claim is determined and accepted. Any resolutions of the meeting are taken by a simple majority of the voting rights and the majority has to be at least 50 % of the value of the unsecured debt of the debtor. The meeting is also responsible for verifying the claims of the creditor and applying to the court for the replacement or removal of the administrator. Furthermore, the meeting also supervises the administrator and selects the members of the committee. Additionally, it decides on the suspension or continuation of the business operations and approves any restructuring or settlement agreements. Finally, both the management and distribution of the properties of the debtor are handled by the meeting [19].

An important part of the bankruptcy process is that any creditor that has debts to the debtor may request that the claims are set off against their claims. However, if the creditor incurred the debt knowing that the debtor is not able to cover their debt, then this is not permitted.

Any contracts before the acceptance of the bankruptcy application and not yet fully performed can be terminated or continued based on the judgement of the administrator. However, the administrator has to notify the counterparties of the decisions within two months after the acceptance or 30 days after the receipt of a reminder. If this is not performed, then the

contract will be terminated. In the case where the contract is continued, the counterparty has the entitlement to a guarantee by the administrator. Failure to provide will terminate the contract as well.

Following this establishment of contracts, the priority of debt cover is determined. This incorporates bankruptcy expenses and common interest debts that are incurred after the acceptance of the bankruptcy petition. Furthermore, employee claims, and social insurance premiums in addition to outstanding taxes are to be reimbursed. Finally, unsecured claims in bankruptcy are to be covered. In case the bankruptcy does not lead to the satisfaction of the discharge requirements, then the allocation will be done on a pro-rata basis.

This implies that secured creditors have generally priority concerning the value of the secured properties, and any shortfalls of these amounts are treated as unsecured claims.

Rescue options play a critical role in Chinese bankruptcy laws, and the Bankruptcy Law permits the debtor and creditors to apply for restructuring or reorganization of the business. The legislation permits to have a compromise or settlement of the debts even if the bankruptcy application was accepted already [20].

The debtor has to submit a draft restructuring plan to the court and meeting of the creditors within six months after the court permits the restructuring request. Within the restructuring period, the debtor may apply for approval from the court to manage the properties and business that is under the supervision of the administrator.

The voting groups are classified by the type of creditor. The first group are those with secured claims of the specific properties. The second group incorporates employees with claims on salaries, and medical/disability subsidies. Furthermore, creditors that are subject to outstanding taxes and common claims are separate voting groups.

4 ISLAMIC BANKRUPTCY PRINCIPLES WITHIN CHINESE BANKRUPTCY LAW

The growing diversification of the Chinese economy and active engagement with many Muslim countries has presented a considerable opportunity for China to pivot new forms of finance adhering to Islamic principles and integrate more readily the systems of these countries. Given the growing trading and economic relationship, Islamic bankruptcy principles may provide both a domestic and international opportunity for fairer financial transactions and responsible business practices. Recent large-scale bankruptcies such as the HNA group, the economic struggles of the Evergrande group and other real estate developers that went into bankruptcy, such as Risesun Real Estate Development Co., Ltd. with more than 37 billion USD in liabilities, represent significant challenges [21]. In several of these instances, excessive leverage and the shielding of the assets of the owners are major cornerstones of these instances.

The number of bankruptcies in China has increased significantly within the last several years. As demonstrated in **Erro! Fonte de referência não encontrada.**, the number of bankruptcies has increased from around 3,000 per year to more than 10,000 within the last four years. This significant increase makes sound bankruptcy proceedings essential and ensures that creditors are protected and the businesses engage in sound business activities. While increasing bankruptcies are caused by a variety of factors, such as economic hardship and growth restrictions, bankruptcy-supporting regulations may cause corporations to prefer to declare and get rid of their debt, instead of the owners supporting the corporation and focusing on repaying the loans to creditors.

To integrate Islamic bankruptcy principles within Chinese law, there are generally two options. The first option is to integrate Islamic principles into general bankruptcy law with a particular focus on ensuring that the concept of limited liability is restricted to ensure greater

responsibility of decision-makers. The second alternative is to create a separate bankruptcy law based on Islamic principles and apply this to specific Islamic entities.

Integrating Islamic bankruptcy principles into Chinese bankruptcy law may be in various forms. The first and foremost option for integration is the abolishment of interest paid on outstanding debts. Given that an enterprise or partnership is in distress, the charging of interest on the debt will make it harder for the corporation or managing individuals to recover and repay these amounts. Furthermore, they may be encouraged to actively seek to repay debtors and be prudent in their business activities. Conventionally, the increasing debt amounts arising from interest puts the defaulting entity under massive strain and will make the debtor more likely to try to default as compared to attempting to find an amicable solution and pay off the debt. Specifically, debts should generally not be forgiven unless the individuals want to make a good deed. If the debtor is in real hardship due to circumstances that are beyond his control, then debt forgiveness if the credit-bearing entity can afford it, should be encouraged. In return, the creditor may receive a preferential mention and positive support from the government. Furthermore, if a debt is forgiven, the debtor should be obliged to contribute to charity or support others as a condition for any debt relief by creditors. This is explicitly emphasized by Islamic principles of doing good and supporting society.

The second approach is to establish an Islamic bankruptcy law that adheres to Islamic principles and applies to Islamic-compliant corporations. The benefit of such an approach is that it would encourage the formation of a strong Islamic financial system, and also enable foreign enterprises to set up Islamic-compliant entities that adhere to their faith. Furthermore, it creates a dual system with separate legal forms that may be easier to be implemented and can be in conjunction with a strong Islamic financial regulatory system. This helps in strengthening the Islamic finance system within China and encourages its growth may align with the objectives of the government for greater common prosperity and sound financial management.

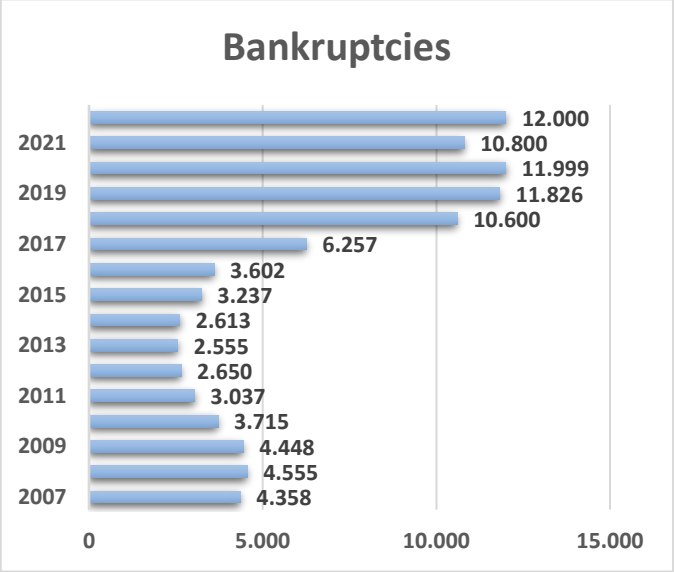


Figure 1: Chinese business bankruptcies from 2007 to 2022
Source: World Bank

5 CONCLUSIONS

Islamic bankruptcy law and Islamic finance have taken on a growing role in modern economies with several governments aiming to align the economic system with Islamic principles in addition to solving some of the shortcomings with existing financial regulations

related to bankruptcies. China has within the last 40 years become a major economy with significant development of its legal system. With the increasing growth and engagement with the Muslim world, challenges have arisen with speculative business practices and arising defaults. Furthermore, the growing engagement with Muslim countries has fostered a growing focus to provide Shariah-compliant legal frameworks to encourage trade and ensure the protection of corporations.

Insolvencies and bankruptcies are natural in an economy. However, Islam emphasizes the importance that there should be no distinction between balance sheet insolvency and cashflow insolvency, as well as the importance of personal responsibility for the debts incurred.

The article has presented a solid outline of the Islamic and Chinese bankruptcy laws and how Islamic principles can be integrated into the Chinese legal system. The arising system in the form of either a separate legal system or one integrating these principles into the existing bankruptcy regulations can significantly strengthen debtor responsibility and recovery rates, as well as encourage fairer business practices.

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