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## Shtar Iska Agreement<sup>1</sup>

### Introduction

Loans play a vital and foundational role in modern-day commerce. Yet charging interest (*ribbis*) on a loan between a Jewish lender to a Jewish borrower is prohibited. On a *Torah* level, payments qualify as *ribbis* only when two criteria are fulfilled: (1) the transaction is an outright loan and (2) the interest rate is clearly stipulated from the initiation<sup>2</sup> of the loan (*ribbis ketzutza*). In cases of *ribbis m'Dioraysa*<sup>3</sup>, all parties involved in the loan violate the prohibition of interest at the time the loan document is drafted<sup>4</sup>. This includes the lender, borrower, witnesses, scribes and lawyers who help formulate the document which provides for interest payments.<sup>5</sup> Furthermore, a Beis Din has the right to force a lender to return *Torah* level interest to the borrower.

The Rabbis instituted safeguards to avoid violating *Torah* level *ribbis*, prohibiting one from collecting interest over the course of a business transaction. Examples include but are not limited to: (a) vendors reducing prices in exchange for immediate cash and/or loans which do not have interest rates. This is viewed as "payment for waiting" (*agar natar*, in which the buyer is rewarded for his immediate payment) which parallels the interest received by a lender;<sup>6</sup> (b) loans which do not have the interest rate explicitly stipulated. In these cases, only the lender and borrower, but not the lawyer or the witnesses, violate the *issur* of *ribbis*. Furthermore, a *Beis Din* does not have the right to force the lender to return the interest collected as *ribbis m'dirabanan* to the borrower.

<sup>1</sup> This document is a revised and updated version of an article originally authored by Rabbi Yaacov Feit, Judaic Studies Department Head, Joseph Kushner Hebrew Academy, Livingston, New Jersey.

<sup>2</sup> The simple understanding of this prohibition is that it applies when the stipulation is made at the initiation of the loan. However, the prohibition may also extend to situations where the lender declares that there is explicit interest after the loan is already advanced. See *Mishne Lamelech Hilchos Malveh v'Loveh* 5:11.

<sup>3</sup> It is worthwhile to note the gravity of this prohibition. The Rambam (*Hilchos Malveh* 4:2) notes that a lender in an interest transaction violates six *Torah* prohibitions, and the **borrower** violates two *Torah* prohibitions. *Shulchan Aruch* (Y.D. 160:2) adds that the possessions of one who lends with interest will diminish and the lender is compared to one who denies the Exodus as well as the G-d of Israel.

<sup>4</sup> See *Rambam Hilchos Malveh* 4:2. See also *Mishneh Lamelech* ibid regarding who violates *ribbis*, and when one violates *ribbis m'dirabanan*.

<sup>5</sup> Violations for *ribbis* include simply drafting and stipulating the interest which will accrue (לא תשימון). There is a discussion among rabbinic authorities as to whether one may serve as a consultant or lawyer that facilitates an interest bearing loan. Treatment of this topic is beyond the scope of this article.

<sup>6</sup> See later regarding the issue of late fees.

### The Heter Iska

Charging interest is common practice in the business world. Thus, taking an interest-bearing loan from a Jewish-owned bank or company is problematic. To avoid the violation of *ribbis*, one must restructure the loan into a business venture, whereby the Funder (the would-be Lender) and Receiver (the would-be Borrower) of these funds are considered equal partners. This restructuring is expressed in *Halacha* in the form of a “*Heter Iska*.”<sup>7</sup>

This business venture is formulated based upon a business model found in the *Mishna* in *Bava Metzia* 68a. The *Mishna* writes:

“One may not give a storekeeper money with which to acquire produce for the storekeeper to sell for half the profits. These activities are both prohibited unless the owner gives the storekeeper his wages as a salaried laborer hired to sell the produce, after which they can divide the remaining profits.”

In this model, the investor wants to give money to a storekeeper to split the profits. Rashi (ibid) explains that this classic business investment was structured as half-loan and half-deposit where the partners split the future profits. This structure reduces the risk taken on by the storekeeper as he is only responsible for losses incurred on the half-loan. Losses incurred from the half-deposit are not the storekeeper’s responsibility as he is simply a manager of those funds and is not responsible for their loss. The half-loan is viewed as independent of the half-deposit. Thus, the storekeeper receives his profits only from the half-loan and the investor receives his profits only from the half-deposit.

The above agreement would potentially pose an issue of *ribbis m’dirabanan* and be prohibited, as the investment can be viewed as an exchange where the storekeeper receives a loan in exchange for managing the investor’s deposit. To avoid the issue, the *Mishna* suggests that the investor agree to pay the storekeeper for his managerial services like that of an idle day worker. The halacha is that even a nominal payment suffices for this purpose.

The *Mishna*’s transaction is a true investment in which the profits are split. The *Maharam* of Krakow, one of the great *Torah* scholars of Poland in the 16th century,<sup>8</sup> used this model to restructure a classical loan with interest. Instead of a loan, the transaction is deemed as a business venture that mimics the *Mishna*’s half-loan and half-deposit structure, and the “interest” is viewed as profit from the venture. This is the basis of the modern-day *Heter Iska*.

### Guaranteeing a fixed return in a Heter Iska

Using this structure alone leaves some difficulties as interest on the loan restructured as profit from an investment does not provide a guaranteed, fixed return. Most investors contemplating a debt investment would be unwilling to participate in an *iska* if doing so involved a level of risk typically

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<sup>7</sup> One should not confuse the *heter iska* with a document which permits interest bearing loans per se. It is in fact a document which restructures the loan as will be discussed. As Rav Moshe Feinstein (*Igros Moshe* Y.D. 2:62) explains, the *heter iska* is not a magical incantation or charm that makes interest permissible. While *poskim* technically allow one to use this document without knowledge of its mechanics, it is important that both parties understand the nature of the agreement they are entering into (see *Bris Yehuda* 40:7). The purpose of this article and annotated *heter iska* is to provide parties with an understanding of the nature and basis of the *Heter Iska*.

<sup>8</sup> See *Respona Nachalas Shiva*’a Siman 40.

associated with an equity venture arrangement. As such, standard *heter iska* forms have incorporated conditions<sup>9</sup> diminishing the likelihood of the substantiation of the profits/losses which will be shared by introducing an additional requirement of either (1) two witnesses to testify<sup>10</sup> that there were losses suffered on the investment and/or (2) taking an oath to verify the profits.<sup>11</sup> In lieu of such requirements, the Funder accepts a payment of an annual, fixed percentage<sup>12</sup> and waives all other profits which may be earned from the advanced funds. As finding witnesses or taking an oath is possible but highly unlikely, this clause allows one to invest in an *iska* while protecting oneself from loss. This stipulation allows for the fixed rate to be treated as “assumed profit” of an investment and not interest on a loan.

Advancing the loan in the form of an investment may in fact limit its application. Oftentimes, a person may wish to receive a loan for personal use (e.g. mortgage, student loans) and not for an actual investment. Ostensibly, applying a *Heter iska* to such loans would be difficult as the permissibility of the *iska* agreement is founded on its status as an investment. Nevertheless, many authorities maintain that an *iska* agreement for a personal loan is deemed a valid investment given the fungibility of money and the theoretical possibility that the borrower funds will free up other funds for investment.<sup>13</sup>

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<sup>9</sup> Shulchan Aruch (Y.D. 177:5) rules based on Tosafot (*Bava Kamma* 102a s.v. “*hanosain*”), that the investor is permitted to stipulate in the *iska* agreement that all investments be reserved for a specific enterprise. Failure to comply with the stipulation would result in the manager’s acceptance of all losses, as opposed to half. Stipulations such as these can be made even if they are extreme and unlikely to be fulfilled. For example, the Funder can stipulate that the manager guard the money by burying it in the ground and failure to do so would result in acceptance of all losses. Despite the fact that it is likely that such a stipulation would result in an agreement that resembles a loan, the manager’s option to avoid such a result prevents such a stipulation from being considered *ribbis*.

<sup>10</sup> The Terumas HaDeshen (302) quoted by Taz (Y.D. 167:1) and Shach (Y.D. 167:1) suggests this condition. As mentioned above, despite the fact that producing such witnesses may prove to be difficult, the existence of a possibility of doing so precludes such a stipulation from being problematic. Terumas HaDeshen even permits limiting those who can testify to two specific individuals. Taz points out that this would only be permitted if the witnesses have some knowledge of the business deal at hand since otherwise it would be impossible for them to testify, making the stipulation one that cannot be fulfilled. See Levush 167:1 (quoted by Taz 167:1) who disputes this condition.

<sup>11</sup> Instead of using the condition of the Terumas HaDeshen cited immediately above, Kuntres HaSma (9) and Shach (167:1) quote this stipulation as a viable option.

<sup>12</sup> The profit payment is theoretically due from the recipient on the half-deposit portion. Thus, if the total amount advanced from the investor to the recipient was \$100,000 and the *Iska* agreement included an annual percentage of 7% to be paid by the recipient on the full advance (\$7,000 per annum) based on the anticipated profits, the real fixed rate is 14% (i.e., an expectation of a \$14,000 return on the full \$100,000, constituting a \$7,000 return on the loan amount to be retained by the recipient of the funds, and a \$7,000 return on the deposit amount, which is paid by the recipient to the investor of the funds).

<sup>13</sup> See Responsa Maharsham 2:216, Imrei Yosher 1:108. See also Bris Yehuda 10:7. Rav Moshe Feinstein (Igros Moshe Y.D. 2:62) seems to argue on this point and suggests two alternative approaches for taking mortgages. The first option is for the Funder to give the mortgage via the classical *Heter Iska* with the caveat that he must not be aware the money will be used solely for a home investment. Alternatively, the mortgage should be deemed as purchase of part of the house, where the “Borrower/Manager” rents that percentage from the “Lender/Funder” for the remaining portion of the house.

### Form *Iska* Agreement<sup>14</sup>

I, the undersigned, have received from \_\_\_\_\_ (“Funder”) the sum<sup>15</sup> of \$\_\_\_\_\_ repayable over \_\_\_\_\_ years for the purpose of transacting business in connection with stocks, bonds, merchandise, real estate, or any other investment that I own or may purchase in the future, in which profits and losses are to be equally shared<sup>16</sup>. However, Funder has agreed<sup>17</sup> that I may pay an annual percentage of \_\_\_\_\_%<sup>18</sup> of the advanced funds and waive all other profits which may be earned from the advanced funds, in lieu of such sharing of profits and losses<sup>19</sup>, which sharing would require substantiation of all losses by two trustworthy witnesses<sup>20</sup> and verification of all profits by oath<sup>21</sup>. I have received a token payment of \$1.00 from Funder for my efforts<sup>22</sup> in connection with this undertaking.

SIGNED THIS \_\_\_\_\_ day of \_\_\_\_\_ in the year \_\_\_\_\_.

\_\_\_\_\_  
Recipient’s Signature

<sup>14</sup> **IMPORTANT NOTE:** This form is a “stand-alone” agreement for use when no other loan documents are executed. Where the parties execute additional documents, the Funder should also sign the *Iska* document and additional language may be required to clarify how the various documents relate to one another in the event of contradictory terms.

<sup>15</sup> The language of the *Iska* Agreement is consciously crafted to avoid the use of the terms “loan,” or “borrower” and “lender.” See *Bris Yehuda* 40:15.

<sup>16</sup> As modeled from the *Mishna* B.M. 68a.

<sup>17</sup> The manager of the funds has the option to either take an oath or pay a fixed sum in lieu of the oath. If he was obligated to only pay the sum that payment would certainly be considered interest (See *Chochmas Adam* 142:12). Since he has an option to take an oath, the payment is viewed as a way of exempting himself from the oath.

<sup>18</sup> Rav Moshe Feinstein (*Iggerot Moshe* Y.D. 2:62, 3:40) points out that since this sum is in lieu of an oath which would declare that the anticipated profit was not reached, the sum must relate to the anticipated profit. As such, the sum must be based on a realistic estimate of anticipated profit and cannot be a figure that would be impossible to attain. Since the *iska* agreement equally shares losses and profits, the fixed amount should equal half of the anticipated profit (see note 12 above). For example, if it is reasonable to assume that no more than an 18% profit is possible, the amount of the fixed percentage declared should be no more than 9%.

<sup>19</sup> With respect to the formulation of the Heter *Iska* as a half-loan/half-deposit, there are some poskim who recommend formulating the *iska* as a “total deposit” (“כולו פקדון”). See *Responsa Chelkas Yaakov Chelek* 3 Simon 188. However, *Bris Yehuda* 4:2, ft. 2 discourages such formulation as it is deemed a “noticeable subterfuge,” as it is unlikely someone would deposit large amounts of money in this manner.

<sup>20</sup> As per *Terumas HaDeshen Siman* 302.

<sup>21</sup> As per *Shach* Y.D. 167:1.

<sup>22</sup> This payment is in the place of the payment of the “idle-worker” mentioned in *Bava Metzia* (68a). While the *Gemara* B.M. 68a argues that the payment is that of an idle day worker, which is obviously larger than the sum of one dollar, the *Shulchan Aruch* (Y.D. 177:3) rules that when the remuneration for effort is set at the time of the *iska* agreement even a minimum payment of one *dinar* suffices. Rav Moshe Feinstein (*Iggros Moshe* Y.D. 2:62) writes that a dollar or even less satisfies this requirement.