

Ribbis Fundamentals: Part IV

HETER ISKA

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WHAT IS A HETER ISKA?

While many people think of a *heter iska* simply as a loophole that allows someone to lend money with interest, this is really not the case.

The Chofetz Chaim speaks at length in Sefer Ahavas Chesed about the importance of explaining to the lender what a *heter iska* really does and what it does not do. The following true-life story displays the misconceptions many have about *heter iska* and the importance to dispel them.

A young man had an idea for a new business. He approached a wealthy man and asked for funding. The man agreed to lend him the money with a *heter iska*, and the young man got to work creating his business. Unfortunately, like many upstart businesses, this one was a failure. The rich man asked for his money back, but the young man told him that all the money was gone and he could not repay him.

They went to a *rov*, who asked the *gevir* if he believed the young man when he said that he lost the money in his attempted business venture. "Of course," the wealthy man said. "He's a *shlemazel*. He lost all the money. But he still has to pay me back because I gave it to him as a loan."

The *rov* informed him that he was mistaken. He explained that a *heter iska* transforms a loan into an investment. Since he had given the money as an investment, he also accepted the risks involved in the business; therefore, if he acknowledged that the business he invested in has failed, he has to accept the loss.

It should be noted that other *rabbanim* disagreed with this *rov's* ruling; however, it is clear that the wealthy man in this story was unaware as to how a *heter iska* works. This illustrates how important it is for those using a *heter iska* to be informed about the basics of what a *heter iska* actually is.

HARAMAH:

A *shailoh* was once asked by someone who wanted to invest in

a business that buys and sells cell phones. The investor wanted to write a *heter iska* that would allow him to lend \$100,000 to the founder of the business, who would guarantee that he would receive his principal money back, and would also give him 50% of the profits. Since a *heter iska* transforms the transaction from a loan into a business deal, he wanted to know if these terms would be acceptable according to halacha.

To answer this question, we must quote a Mishnah (BM 70b) that says that it is forbidden to initiate a "*tzon barzel*" investment. In short, this means that if the investor takes no risk and is guaranteed to receive the money he invests in return, plus a percentage of the profits, such a transaction is forbidden, as it is viewed as a loan that is being repaid with interest.

Rabbeinu Tam explains that this is a form of *ribbis d'ohraysa*. As was mentioned in a previous shiur, if the money is given in the form of a loan and the amount of interest is agreed upon in advance, it is forbidden by the Torah. Rabbeinu Tam says that the case in this Mishnah fits this description.

If, however, the investment is made with no *guarantee* of getting back the money he invested, even if he is promised a set profit if it is realized, it would not be forbidden by the Torah. Because the investor accepts that he will either make money or lose his investment, it would not be *ribbis d'ohraysa*.

KAROV L'SCHAR V'RACHOK M'HEFESED:

The converse is true as well. Even if the principal is guaranteed, if there is no set amount of profit being promised, only a portion of profits that are actually realized, this would not be *ribbis d'ohraysa*. However, Rashi tells us that although this case is not *ribbis d'ohraysa*, it is still forbidden as *ribbis d'raban*. He calls this case "*karov l'schar v'rachok m'hefese*," the chances of the investor making a profit are much greater than the chances of losing anything, and he says that such cases are forbidden by the *rabbanan*.

The way to get around this problem of *ribbis d'raban* is

through *haramah*, which literally means deceit or trick. It basically translates as creating a clause in the deal that circumvents the problem, even though everyone understands that the term will not be acted upon. "Tricks" like this can be used for *ribbis* when even without the trick it is only forbidden by the *rabbanan*, but would not be permitted for the more severe *ribbis d'ohraysa*.

A *haramah* that is commonly used for a *heter iska* is to state that although the investor accepts liability for losses the business might incur, he will only believe that the losses were suffered by the business if two kosher witnesses testify to the loss and that it wasn't incurred through negligence. It is almost impossible for witnesses to testify that they know for a fact that the losses occurred specifically to the money that he invested, that they came as a result of typical business practices, and were not due to negligence by the business owner. Therefore, this term can almost never be fulfilled. This means that the investor can rest assured that he is accepting almost no risk to his capital investment, but the deal is permitted according to halacha, thereby circumventing the problem of "*karov l'schar v'rachok m'hefeseh*".

PAYING FOR WORK:

A separate problem in a typical *heter iska* is that the one receiving the money seems to be working for free. If someone invests in a business and expects to accept 50% of the profits, while his partner does all the work, it would be reasonable to ask why this partner is the only one working but is giving away half of his business earnings. The only logical answer would be that he is working in exchange for the money that was lent to him to start the business. This would make it seem as if his work, which has value, is being given as payment in excess of the amount of the money lent, which would seem to clearly be *ribbis*.

The solution for this would be for the investor to pay his partner for the work he does. In a case where the *ribbis* is only *d'rabanan* – meaning where the investor has no guarantee that he will receive his full investment back – a *haramah* can be used for this. The one receiving the money can be paid a very minimal amount for his work, even as nominal as \$1. Of course, this is simply a trick, but because we are dealing with *ribbis d'rabanan*, it is permitted.

HOW TO SOLVE RIBBIS D'OHRAISA:

As mentioned, *Haramah* would only help in cases of *ribbis d'rabanan*; however, we are still left with a problem in cases of *ribbis d'ohraysa*. As we've seen from Rabbeinu Tam, any arrangement wherein the principal and the profit are predetermined and secure, a *haramah* cannot be used. How can this problem be solved?

First of all, the *heter iska* has to be worded in a halachically acceptable way. For example, some Jewish-owned banks require borrowers to sign contracts that say that the *heter iska* is meant only "for religious purposes" and cannot be enforced

in any way, and any disagreement will only be adjudicated in a court of law. Of course, this makes the *heter iska* into a joke and destroys any credibility it may have had.

Even if a *heter iska* is written seriously, it still must contain some type of clause to get around the problem of *ribbis d'ohraysa*. The way to do this is to craft it in a way that would not constitute a *haramah*.

This is commonly done by writing into the *shtar* that although the lender/investor accepts liability for incurred losses, he only will do so if the one who received the money swears that the loss was business-related with a *shavuah d'ohraysa*. Such a condition is found in the Mishnah regarding other transactions and is considered a fair and acceptable clause. Since the one who received the money will generally not wish to make such a promise, the investor can be confident that his money is safe, and the *heter iska* is halachically valid. To facilitate a predetermined amount of profit, it is common to include an escape clause, namely that the receiver may choose to pay a predetermined amount in lieu of an oath.

OTHER TYPES OF HETER ISKA:

The original form of *heter iska* was created several hundred years ago by a *gadol* named Rav Mendel. The way it worked was that the investor gave the money as a full investment until it reached a certain amount of profit, at which point it reverted into being a loan. For example, the investor gave his partner \$100, with the agreement that the partner would work for him until the money invested reached a value of \$200. At this point, it would be considered a loan that the partner had to pay back in full, with no interest being charged over and above the \$200.

The Shulchan Aruch approves of this type of *heter iska*, adding that the partner/borrower should be paid a nominal amount for the work he put in on growing the business. The Vilna Gaon, however, has a problem with this framework. He notes that until the investment reaches \$200, the borrower is working for the business. If he has to repay the money, which is now a loan, it turns out that he had been working for free. He says that this could constitute *ribbis d'ohraysa*. Perhaps it is because of this problem that this type of *heter iska* was mostly discontinued and is rarely used today.

Today, one common practice is for the *heter iska* to be written in a way that all the money is given in the form of an investment, and it remains an investment without ever reverting to be a loan. The partner who receives the money is paid a share in the profits in the form of payment for his work for as long as the deal is ongoing. In order to lessen the investor's liability, the clause that requires the partner to swear about any losses is put into the *heter iska*. However, some Rishonim indicate that this would itself be a forbidden form of *haramas ribbis*.

Since every scenario is different and there can be many variables, it is important to make sure that each *heter iska* is written correctly for that particular investment arrangement.