



SHARIYAH
REVIEW BUREAU



Crypto Assets: Zakat of the Digital World

May 2023

وَآتُوا الزَّكَاةَ

سورة المجادلة، ١٣:

What is Zakat?

Zakat is the third of five core pillars of Islam and by Quranic ranking, is next after Prayer in importance. Many scholars hold the view that Zakat brings order to the chaos in the economy, markets and society, allowing the economy and all its participants to recognize Allah (SWT).

The commands of Islam all have multi-dimensional benefits. Ultimately, whatever is commanded by Allah – who is All-Wise – will have multiple functions, wisdoms, and benefits. Some of the functions of Zakat include:

- Financing the growth of faith and the faithful.
- A human capital fund which seeks to empower individuals.
- Guaranteeing every struggling person, a baseline provision and support to give them more opportunities to break out of the cycle of poverty
- Acting as liquidity injections to the market.
- Producing an economic stimulus by activating consumer spending.
- Facilitating social engagement between communities to look after one another and to grow together.

Zakat is due on one's personal assets but is never payable on one's residence, vehicle, clothing, electronics so on and so forth. Zakat has been made obligatory on specific assets: gold, silver, cash, business stock, receivables, investments in these assets, agricultural produce and livestock.

Zakat also has multiple benefits for various stakeholders.

Benefits for the payer includes:

- subservience to Allah in one's life.
- gratitude for the blessing of one's wealth.
- purification of the soul.
- means to multiply one's reward for the Hereafter.
- sympathise and show compassion for the less fortunate.
- means to bless and purify one's wealth.

Benefits for the recipient include:

- alleviating poverty.
- Removing ill-feelings and spiritual diseases in the needy such as jealousy, rancour or malice against those who have wealth.
- allow the recipient to survive and get free access to basic necessities.

Benefits for the society include:

- Zakat is a means of developing and strengthening the Islamic economy.
- Zakat is a means of Da'wah and propagation of Islam.
- Bridge the gap between the rich and the poor
- Develop brotherhood and sisterhood between different classes of society.

Key Calculation Principles of Zakat

The calculation principles are of three types:

1. Principles relating to the payer
2. Principles relating to wealth
3. Principles relating to Zakatable assets

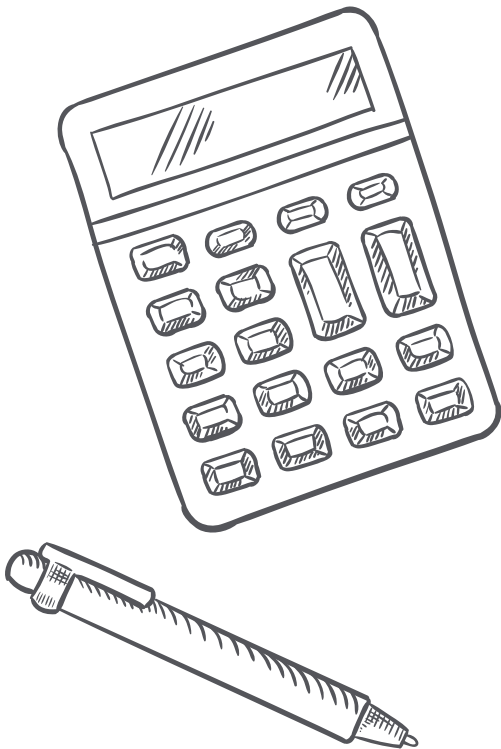
The summary of each of the above is as follows:

1. Principles for the payer

A Zakat payer must fulfill the following conditions:

- a. Muslim
- b. Adolescence
- c. Mental Capacity

Only the Hanafi school conditions adolescence and mental capacity. The rest of the Islamic schools of law are of the view that the wealth of a minor and the wealth of one who lacks mental capacity is Zakatable.



2. Principles for wealth

The principle for wealth is as follows:

- a. **Ownership**
- b. **Possession**
Possession is a requirement for Zakat to be binding on wealth. Possession includes:
 - actual possession in one's hands or constructive possession where one has access or has delegated control to another party.
 - assets that are invested, whether locked-in or accessible during the investment period.

- c. **Productive Assets**
Zakat is only due on assets that are owned for exchange purposes like cash which by design is for exchange, or stock and inventory which are acquired to resell for profit and a return, or on assets that naturally grow in units and size. In the context of Zakat, this is referred to as *Mal Nami*.

The following assets are productive:

- Cash and Receivables
- Gold and Silver
- Stock and inventory
- Animal livestock
- Crops

If the above assets are part of any investment, they will also be Zakatable.

- d. **Nisab**
Another requirement for wealth to be Zakatable is that the wealth should equal or exceed *Nisab*. *Nisab* is the threshold upon which Zakat becomes binding. The *Nisab* is 87.48 grams of gold or 612.36 grams of silver in one opinion. Another view is 85 grams and 595 grams respectively.

- e. **Passing of a lunar year**
Zakat is only payable after one lunar year passes and one has Zakatable wealth equal to or above *Nisab* at the Zakat year-end. If at year-end the Zakatable wealth is below the *Nisab*, Zakat will not be payable, and that date is no longer valid as one's Zakat year-end. The AAOIFI Sharia Standards permits the usage of the Gregorian calendar. If the Gregorian calendar is used, the Zakat rate will be 2.577%.

Zakat on Investments

Assets are generally purchased for one of following three reasons:

1. Personal use:

This refers to assets purchased for personal use. Such assets will be deemed personal belongings and are not Zakatable (except cash, gold, silver etc.)

2. Investments:

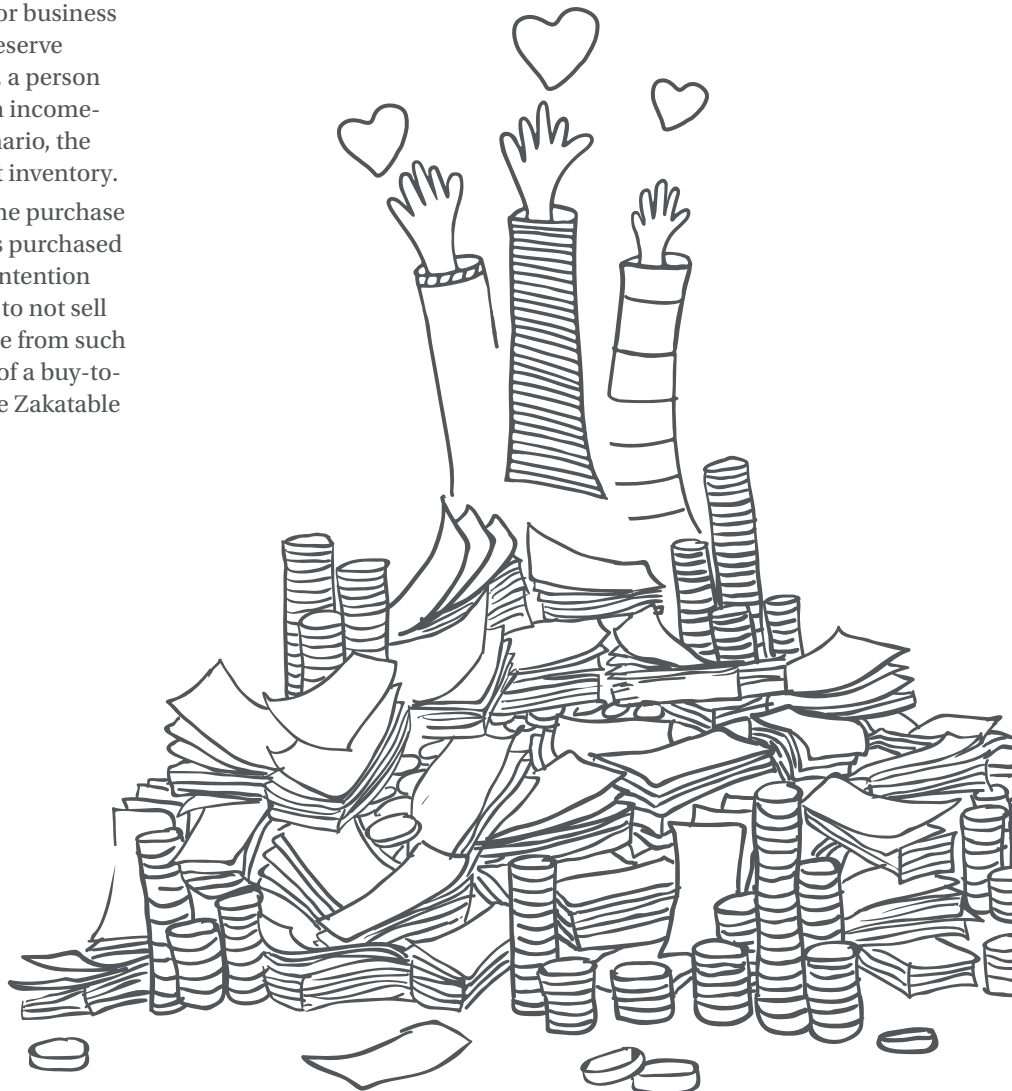
a. Store of value - This refers to an asset that is purchased to preserve and maintain one's wealth in a form other than money. This asset may appreciate in value but is not from *Mal Nami* and maybe purchased to hedge against inflation risk that is prevalent in fiat currency. An asset purchased solely as a store of value will not be a type of a Zakatable asset of either cash or stock or inventory. Rather, this is a type of investment (*Istithmar*) where the objective is long-term wealth preservation without any immediate intention to do business or sell the underlying. For example, a person purchases property, or purchases land or a collectible, not for business purposes, but to simply store and preserve the value of his wealth. Alternatively, a person may use this as a capital asset and an income-generating asset. Even in such a scenario, the asset will not be Zakatable as it is not inventory.

b. Income generation - This refers to the purchase of an income-generating asset that is purchased for dividends or rental income. The intention underpinning such an acquisition is to not sell the asset, but to earn ongoing income from such an asset. For example, the purchase of a buy-to-let property. Such an asset will not be Zakatable either.

3. Business:

This refers to an asset purchased as inventory with the intention for resale and to make profit in the ordinary course of business regardless of what the asset is. Such assets are stock and inventory and will be Zakatable.

Certain types of trade assets may take longer to resell due to the business model and operating cycle. For example, a property trader whose business is to purchase property and then flip the property on with a view to make a short-term gain through a refurb, may take longer to realise the inventory than a grocery store. For such a property trader, these properties will still be Zakatable even if it takes two years to eventually on-sell. The property trader will be required to pay Zakat annually on the fair market value of the property on their Zakat year-end.

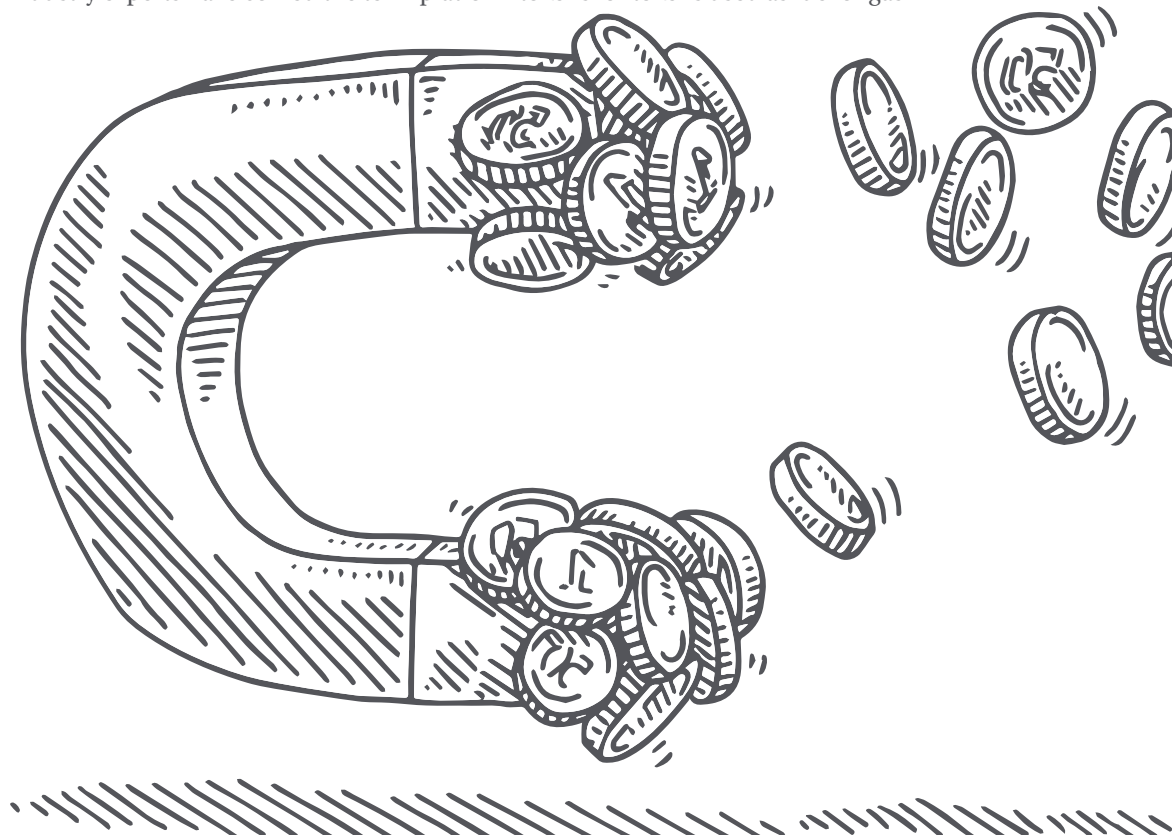


Different types of Crypto-assets

Crypto-assets can be defined as “digital representations of value that use cryptographic encryption techniques.” A token can represent a medium of exchange, an asset, a utility, service, a right or anything. According to Ernst & Young, a token tends to be designed to support a more narrowly defined, specific use case of distributed ledger technology.

Crypto-assets can be divided into the following types:

- 1. Cryptocurrencies/currency coins/tokens/transactional tokens** – e.g. Bitcoin, Litecoin and Dash are examples of cryptocurrencies and currency tokens, since their primary utility is to serve as a medium of exchange and transfer value. FCA calls these “exchange tokens”.
- 2. Security tokens** - PwC define security tokens as “digital tokens based on blockchain technology that are similar in nature to traditional securities. They can provide an economic stake in a legal entity: sometimes a right to receive cash or another financial asset, which might be discretionary or mandatory; sometimes the ability to vote in company decisions and/or a residual interest in the entity.
- 3. Utility tokens** - provide users with access to a product or service and derive their value from that right.
- 4. Asset-backed tokens** - According to PwC, an asset-backed token is “a digital token based on blockchain technology that signifies and derives its value from something that does not exist on the blockchain but instead is a representation of ownership of a physical asset (for example, natural resources such as gold or oil)
- 5. Governance tokens** - grant their holders governing rights on a protocol.
- 6. Platform tokens** - Some industry experts have coined the term platform tokens for tokens used as fuel or gas on a network.



Zakat on Crypto-assets

The Zakat treatment of crypto-assets depends on two things:

- The type of crypto-asset
- The investment and trading strategy in crypto-asset

1. Coins/exchange tokens/Payment tokens

Zakat is always due on these types of crypto-assets at 100% of your current holding value regardless of the intention and trading strategy.

2. Security tokens

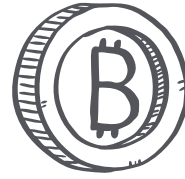
If these tokens represent ownership in an asset and the tokens are purchased to resell, then it is Zakatable at 100% of your current holding value. If purchased for dividend income & long-term investment, Zakat will depend on the underlying assets of the company.

3. Utility tokens

If these tokens represent ownership in an asset and the tokens are purchased to resell, it is Zakatable at 100% of your current holding value. If purchased to use, Zakat will not be due on these tokens.

4. Asset-backed tokens

If purchased to resell, it is Zakatable at 100% of your current holding value. If purchased as an investment, Zakat will depend on the underlying asset. If it is a Zakatable asset, it will be Zakatable.



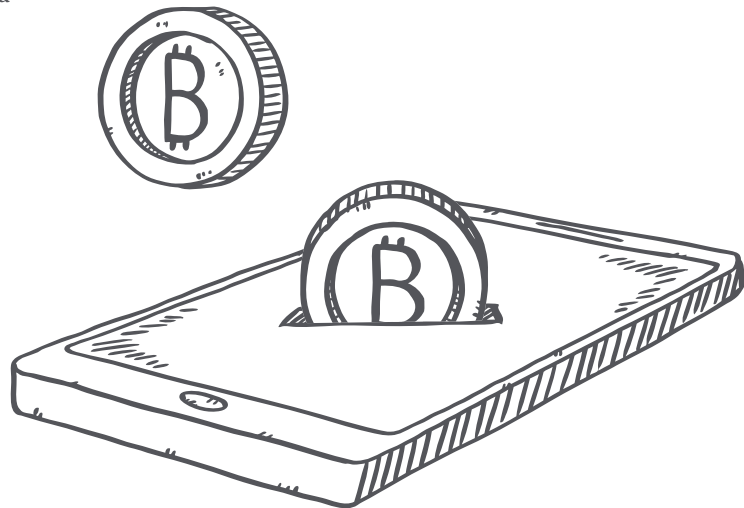
5. Governance tokens

If these tokens represent ownership in an asset and the tokens are purchased to resell, it is Zakatable at 100% of your current holding value. If purchased to use, Zakat will not be due on these tokens.

6. Platform tokens

If these tokens represent ownership in an asset and the tokens are purchased to resell, it is Zakatable at 100% of your current holding value. If purchased to use, Zakat will not be due on these tokens.

As a principle, whenever a person trades tokens that represent assets, purely with the intention to resell or to buy-low and sell-high, then Zakat is due on the full value of the investment at market value.



Crypto-trading strategies and Zakat

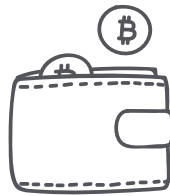


Following on from the above, crypto-assets are traded and invested with the following strategies:

1. Buy-and-hold

This is where a person does not do 'business' in the crypto-asset. They are not trading the cryptos and are not looking to resell in the near future. Instead they are seeking long-term growth and value. They are holding their assets and acquisitions as part of a portfolio with no intention to sell at present.

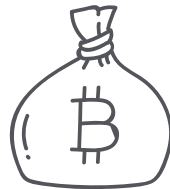
Zakat is not due on the full value of the investment in such a strategy. Zakat is only due on the exchange tokens or crypto-coins such as Bitcoin in this instance.



2. Savings, investments & store of wealth

This is where a person acquires assets or securities with no intention to sell at present even though he knows he will certainly sell one day in the future for capital gain. However, at present they have no intention to sell.

Zakat is not due on the full value of the investment in such a strategy. Zakat is only due on the exchange tokens or crypto-coins such as Bitcoin in this instance.



3. Active trading

This is where the trader is 'trading' and doing business in assets and securities. This is their business or side business, and they seek an income or additional income through this buy-and-sell activity. This also includes a one-off purchase with the intention to resell soon to capture short-term positive price fluctuations.

In an active trading strategy, there is no uncertainty in the intention to on-sell immediately. That is the firm intention. There is only uncertainty in the price and the trader is seeking to sell at the best price possible.

In an active trading strategy, Zakat is due on the full value of the investment at market value.

Case Studies

Disclaimer: The below tokens have NOT been reviewed by Shariyah Review Bureau and their mention does not mean they are considered as compliant to the principles of Sharia. The tokens below are just mentioned as case studies based on how the tokens have been described publicly without any further Shariah review.

1. Transactional tokens and payment tokens

Transactional tokens are used to transact—they serve as units of account and are exchanged for goods and services. These tokens often function like traditional currencies, but in some cases, provide additional benefits. For example, with decentralised cryptocurrencies, such as Bitcoin and Dai, it is possible for users to execute transactions without a traditional intermediary or central authority, such as a bank or payment gateway.

Bitcoin is a prime example of a payment token. It's meant to be used for transactions between parties in place of or alongside traditional fiat currencies.

Other examples of payment tokens include Litecoin, Dash, and Bitcoin Cash. These tokens all have the simple goal of allowing you to pay for things in the real world using digital currency. Monero and Zcash are also payment tokens, though they have privacy features that make them more complicated.

Since Bitcoin, Monero and Zcash are designed as payment systems, Zakat ought to be paid on the full value of these crypto-assets regardless of one's intention upon acquisition.

2. Utility tokens

Utility tokens are integrated into an existing protocol on the blockchain and used to access the services of that protocol. They are not created for direct investment like security tokens, but can be used for payment of services within their specific ecosystems. The relationship between a platform and a utility token is synergistic, as the platform provides security for the utility token while the token provides the network activity necessary to strengthen the platform's economy. For example, Dai is integrated into Axie Infinity, a digital-pet universe with a player-owned economy, providing players with a stable in-game currency. In the same way, utility tokens power a platform, and you can use the tokens to get value from the platform. Ether, Ethereum's token, is the most famous utility token. You can use ETH to pay for smart contract execution on the Ethereum network. While you can make payments in Ether, and many people do, its primary purpose is to power the contracts, dapps, and DAOs that run on Ethereum.

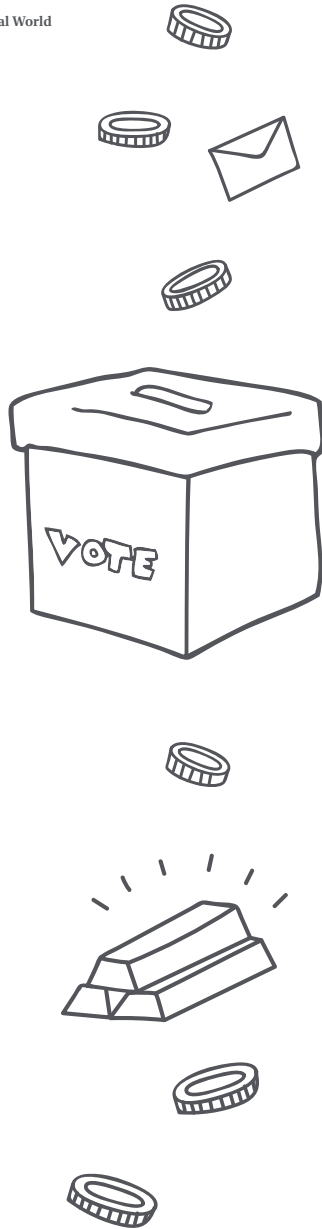
If a person purchased Ether purely to resell with profit, then Zakat will be due on the full value. However, if a person purchased Ether not to resell, but to use or hold as part of their portfolio for long-term with no intention to sell now, then Zakat will not be due on Ether.

3. Security token

Security tokens can represent property interests. For example, investors on the Meridio platform can seamlessly trade tokens representing real estate shares and pay in Dai, while Fluidity Factora allows people to invest in a Brooklyn, New York, property by paying with Dai.

In a case where a token represents ownership of an off-chain asset, such as real estate, equipment, payable invoices, or a business, similar to a share of stock, the security token's value is directly tied to the asset's valuation; the more valuable the asset, the more valuable the token.

Such tokens represent shares and therefore, Zakat will be due on the net Zakatable assets if a person has purchased such tokens for long-term and not to resell. However, if a person has purchased such tokens to resell, then Zakat will be on the full value of the tokens.



4. Governance token

As decentralized protocols continue to proliferate and evolve, the need to refine the decision-making processes around them is critical. On-chain governance allows all stakeholders to collaborate, debate, and vote on how to manage a system. Governance tokens fuel blockchain-based voting systems, as they are often used to signal support for proposed changes and to vote on new proposals. In the Maker Protocol, the governance token is MKR.

If a person purchased MKR purely to resell with profit, then Zakat will be due on the full value. However, if a person purchased MKR not to resell, but to vote or hold as part of their portfolio for long-term with no intention to sell now, then Zakat will not be due on MKR.

5. Asset-backed tokens

Tokens that are backed by a real asset, such as gold, are called asset tokens. These tokens represent the value of real assets and can be used for buying/selling the assets that they back. This improves the trading of physical assets on digital platforms. Launched by PAXOS, PAX Gold is a crypto-asset that attempts to solve the twin problems of gold storage and the use of gold as a medium of exchange. The company pledges that every PAX Gold token is fully backed by vaulted physical gold in London. One digital token represent one troy ounce of LMBA good delivery gold. They also affirm to investors that the gold is audited on a monthly basis. As PAXG tokens represent a claim on one troy ounce of physical metal, it reliably tracks the LMBA gold spot price.

An owner of a PAX token can enter their token's Ethereum address into the PAX website and find the serial number of the physical gold bar that it is backed by. A token can also be redeemed for physical gold. However to take delivery you need to own at least one London Good Delivery Bar (LGDB), which is in the order of 400 troy ounces. PAX tokens can however be redeemed in smaller amounts through participating gold retailers.

Based on the description of the PAX Gold token, Zakat will be due on this token annually as it represents ownership in gold.

Conclusion

Zakat is the third of five core pillars of Islam. It has multiple benefits, wisdoms and functions. These benefits are shared among the payers, beneficiaries, the market and the economy. Zakat is not payable by everyone; rather the obligation of Zakat is dependent on the payer fulfilling the criteria such as ownership, possession, owning Zakatable assets equalling *Nisab* and the passing of a lunar year and still owning *Nisab*. Similarly, not every investment is Zakatable; Zakat is due on something purchased to resell as the primary intention where that underlying asset is treated as stock and inventory, similarly, investments in Zakatable assets are Zakatable. However, investments into anything else for any other reason will not be Zakatable. Crypto-assets follow the same principles as other securities and investment asset classes. As such, the nature of the crypto-asset will be reviewed for Zakat purposes. If any token is purchased to resell, then Zakat will always be due on such tokens on their full value. However, if the intention is not to resell for profit, then the Zakat treatment will depend on the type of token. Transactional tokens such as Bitcoin are always Zakatable as they serve as a medium of exchange. Security tokens are Zakatable in accordance with the underlying Zakatable assets. Utility tokens that are not bought to resell are not Zakatable. Asset-backed tokens will be Zakatable if they are representing a Zakatable asset like gold. Governance tokens will not be Zakatable when purchased to vote or hold long-term without any intention to sell.



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Disclaimer

This is a preliminary Shariah research and is by no means a definitive conclusion or fatwa on the aforementioned subject. This paper was written to develop knowledge and research on this complex subject from a Shariah perspective. We hope that this paper will prompt and engage global Islamic finance bodies, Shariah scholars and Muslim economists to analyze, comment and build upon the arguments expressed.

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