AMANAH
FINANCE CONSULTANCY

Zakat on Cryptocurrencies

Summary

Any cryptocurrency or token purchased to resell will always be Zakatable. Zakat is due on the market value on one's Zakat anniversary. The cryptocurrency value should be converted into one's local currency at the time of calculation. If a cryptocurrency is not purchased to resell, a coin currency such as Bitcoin, Litecoin, Ripple etc will still be Zakatable because of their utility as currencies within their ecosystem. Zakat on tokens not purchased to resell will depend on the nature of the token and what it represents.

What is a cryptocurrency?

A cryptocurrency is a form of virtual currency that uses cryptography to verify that any person who attempts to spend some of the currency is the person entitled to do so. Cryptocurrencies typically use a decentralised peer-to-peer network to verify transactions and to record them on a decentralised public ledger (which is commonly known as a blockchain)[1].

At their core, cryptocurrencies are really protocols that facilitate transactions between two unrelated parties over the Internet in a manner that gives them confidence that value has been safely transferred from one party to the other. Transactions are recorded in a public ledger and verified through cryptography by a network of decentralized computers. Because no single entity controls these computers, this technology eliminates the need for traditional financial intermediaries and enables the use of cryptocurrencies as a new direct payment option for consumers and merchants. Similar to fiat currencies, cryptocurrencies can be traded on exchanges, managed in wallets, and spent via payment processors. However, unlike other forms of electronic payment, cryptocurrency transactions cannot be forcibly reversed.

Crypto-Coins

It's important to distinguish between coins and tokens, as the two terms are often interchanged in media coverage. A coin is a unit of value native to a blockchain. It is a means of exchange within the blockchain to incentivise the network of participants to use the blockchain.

[1] Norton Rose Fulbright (2017), Deciphering Cryptocurrencies [online]

The sole purpose of a coin is to exchange value, and it has limited functionality beyond that. Cryptocurrencies like Bitcoin, Ether, Ripple, and Litecoin are all examples of native coins. In the Bitcoin network, the coin is bitcoin [BTC], in the Ethereum network, it is Ether [ETH]. Typically, there are only two things that can be done with a coin: (i) to send it to someone else and (ii) to pay for transaction fees in the system. If it can do more, it is a token[2].

From a Shariah perspective, since these cryptocurrencies coins are there to serve as a peer-to-peer payment system and have been regarded as a payment system, they will be currencies. The *Ta'āmul* (common usage) and *Istilāh* (social concurrence) among users of these coins is that of a currency and medium of exchange. The only difference is, Bitcoin has a wider acceptance as opposed to Litecoin and Ripple. Bitcoin has become a currency as a result based on '*Urf 'ām* (widespread custom). Currency coins which are only a means of payment in their networks are currencies due to *al-'Urf al-Khās* (exclusive custom). *Al-'Urf al-Khās* refers to a practice or understanding exclusive to specific people. This specificity can be a result of location, profession, membership or agreement among a group of people. Thus, it is plausible to assume the formation of an exclusive custom built on a blockchain.

Zakat on Coins

Those cryptocurrencies which purely serve the function of remittance and medium of exchange, they will be Zakatable regardless of the intention. They are in the ruling of currency and therefore, Zakatable always.

Crypto-Tokens

If any crypto-token was purchased to resell at a profit, it will be a Zakatable business asset and will be Zakatable at market value. When anticipating increase in market prices and looking for the right price, it will still be Zakatable. If a token is not purchased to resell, the ruling on Zakat depends on the nature of the token and what is represents.

[2] Hillebrand,M. (2017), An Introduction to Initial Coin Offerings in Project Finance, Baden-Wuerttemberg Coperative State University Villingen-Schwenningen. Available from: https://www.aparecium.de/app/download/5810645565/An+Introduction+to+Initial+Coin+Offerings+in+Project+Finance_V1.0.pdf

Tokens vary widely in their design and function. Usually they represent a (prepaid) entitlement to the service to be developed, which may be a reward, or even have no value whatsoever. It may also be that they give entitlement to a share in a project[3]. Different tokens have different functions and purposes. They represent and give access to different things. Some of the common types of tokens are as follows[4]:

1. **Work tokens**

Work tokens give owners permission to contribute, govern, and/or "do work" on a blockchain. An example would be Maker (MKR), which gives owners the ability to govern an organisation that manages the stability of an underlying coin (DAI)[5].

These types of tokens are like licences and permits to certain performances on a blockchain. Thus, they are in the ruling of *al-Huquq al-'Urfiyyah* and are similar to right of passage (*ḥaqq al-murūr*). Therefore, just as *ḥaqq al-murūr* were permitted to be bought and sold according to the majority of scholars, work tokens can also be sold on a secondary market. Thus, the trading work tokens is Shariah compliant.

If these tokens are not purchased to resell and make profit, they will not be Zakatable. Such tokens are in the ruling of a *Haqq* (right).

2. **Utility tokens**

The utility tokens are rights to services or units of services that can be purchased. These tokens can be compared to API keys, used to access the service[6].

These tokens are also rights and are regarded as *Huquq* (rights). Just like work tokens, these tokens give the holder a right. These tokens can also be considered as *al-Huquq al-'Urfiyyah*. Thus, it is permissible to trade such tokens on a secondary market provided that the project is Shariah compliant and it has passed the Shariah screening for ICOs.If these tokens are not purchased to resell and make profit, they will not be Zakatable. Such tokens are in the ruling of a *Haqq* (right).

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[3] AFM (2017), Initial Coin Offerings (ICOs): serious risks [online], [last accessed 30th January 2018], Available from: https://www.iosco.org/library/ico-statements/Netherlands%20-%20AFM%20-%20Initial%20Coin%20Offerings%20Serious%20Risks.pdf

[4] Kruger, A. (2017), An Overview of Cryptocurrencies for the Savvy Investor [online], Available from: https://hackernoon.com/all-you-need-to-know-about-cryptocurrencies-an-overview-for-the-savvy-investor-bdc035b14982

[5] Little, W. (2017), A Primer on Blockchains, Protocols, and Token Sales, Available from: https://hackernoon.com/a-primer-on-blockchains-protocols-and-token-sales-9ebe117b5759

[6] Benoliel, M. (2017), Understanding the difference between coins, utility tokens and tokenised securities [online], Available from: https://medium.com/startup-grind/understanding-the-difference-between-coins-utility-tokens-and-tokenized-securities-a652265fb91

3. Asset-backed tokens

The asset-back token represents a claim on an underlying asset, and to claim the underlying one sends the token to the issuer.

These tokens are similar to Investment Sukuk in the sense that the tokens represents a beneficial ownership and interest in the underlying asset. Constructive possession (*Qabd*) of the underlying asset is realised by the possession of the token in one's digital wallet.

Zakat on these tokens follows the rules of investment Sukuk. Zakat depends on the underlying asset. If the underlying asset is of Zakatable nature, the owner should pay Zakat on the market value of the asset-backed token. If the underlying asset is not Zakatable, there will be no Zakat on such a token not purchased for resell.

4. Equity Tokens

Tokens said to represent equity in the issuing company, giving token holders votes as shareholders, participation in future dividends reflecting some form of ownership in the project as well.

These tokens are similar to purchasing shares in a company. Before investing in such tokens, a Shariah screening of the core business activity and the financials must be carried out like the screening methodology of shares.

Zakat on such tokens follows the ruling of Zakat on shares. If this was brought to resell, the tokens will be Zakatable at market value. Otherwise, Zakat will be due on the percentage of Zakatable assets in the company represented by the token.

Importance of Intention for Tokens

The Zakat treatment for tokens is principally based upon the intention at the time of purchasing the token. Tokens purchased to resell are Zakatable. However, a person can have different intentions when purchasing a token, therefore, it is worth considering the different types of intentions and their consequences in respect to Zakat liability.

1. Clear intention to resell

If a token is purchased with the express intention to resell, it will be a Zakatable regardless of when it is eventually sold.

2. **Clear intention to not resell but to use on the blockchain or network**

If a token is purchased to benefit from its utility to access something or spend on the network, then such a token will not be Zakatable.

3. **No clear intention**

If a token is purchased without any intention or without a clear and express intention, then the token is not Zakatable.

4. **A conditional intention**

If a token is purchased primarily for its utility and benefit of using it on a blockchain with an intention of selling only if there is significant appreciation in value or favourable market conditions, such a token will not be Zakatable.

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