

# CRYPTO GAINS AND THE ZAKAT BENEFITS

## SPEED READ

At the time of writing, the cryptocurrency market has experienced a boom in the last six months, with an increasing breadth of people investing in digital assets, – including Muslims who follow Shariah principles for finance.

The increase in investment by members of the Islamic faith in cryptocurrencies such as Bitcoin and Ethereum has given rise to the question of Zakat payments. Zakat is the third pillar of Islam which requires Muslims to make charitable payments if they have adequate means to do so.

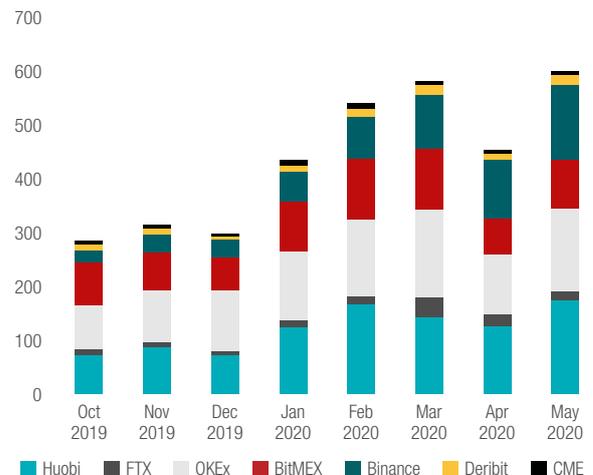
The key questions to consider are whether Zakat is mandatory on crypto investments and how the amount of Zakat on cryptocurrencies should be calculated. This article aims to explore these points and provide a more assured approach on how to view cryptocurrency investments from an Islamic finance perspective.

\*\* This article will not be deep diving on the Shariah permissibility of Islamic financial investments in cryptocurrency. \*\*

## THE GROWTH OF CRYPTOCURRENCY

As of January 2021, there were in excess of 4,000 cryptocurrencies available to trade/exchange. These currencies all have assigned values that fluctuate daily and can be traded on recognised exchanges such as Coinbase, Binance and eToro. Many of these cryptocurrencies are decentralized networks based on blockchain and distributed ledger technology (DLT).

One of the largest exchanges, Coinbase has showed an increase in total transaction volume worldwide from \$195 billion in 2020 to \$335 billion in just Q1 of 2021<sup>1</sup>. According to a survey conducted by Finder, a fifth (19%) of British citizens say they have bought cryptocurrency which is equivalent to 9.8 million people. This indicates that in the UK, the number of cryptocurrency users has surged 558 percent since the beginning of 2018 when just 3 percent of the British population (1.5 million) held some crypto<sup>2</sup>. This is evidence of the strong growth and demand in this market.



Visual historical monthly derivatives volumes from Q4 2019 - Q2 2020 by CryptoCompare<sup>3</sup>

# CRYPTO BENEFITS FOR ZAKAT

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*Zakat is more than just a payment or a random act of charity. It's a unique form of religious social welfare which benefits the whole community.*

- The National Zakat Foundation

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Zakat is to be applied against the full value of any capital held, including cryptocurrency, if purchased with the intention of making financial gains. As prescribed in Islam, 2.5 percent of all income must be utilised in this manner. The application of Zakat is dependent on the individual's calculation of Nisab – i.e. 'the minimum amount that a Muslim must have before being obliged to give Zakat'.

If treating cryptocurrency as a standard security investment, then assessment of any Zakat is not based on the return they generate in earned income and the entire holding is 'Zakatable' at 2.5 percent. For example, if you purchase £5000 of equity shareholdings and the overall value rises to £6000, the Zakat would be 2.5 percent of the total of £6000, therefore £150. The same approach is applicable to cryptocurrency where an asset can be classified as liquid. In this situation 'liquid' is defined as something that can convert quickly into cash while retaining its value.

Dependant on the type of cryptocurrencies held it can be viewed as liquid assets in this manner, they are to be treated as such in regard to Zakat. Table 1 below highlights the different types of crypto-assets and their Zakat impact.



## What is Nisab

Nisab is an affordability threshold, referring to the minimum amount of wealth and possessions that a Muslim must own before being obligated to pay Zakat. This means that if a Muslim's personal wealth is below the required Nisab level during one lunar year, no Zakat is owed for that period. This threshold is the equivalent value of three ounces of gold or 21 ounces of silver. At the time writing this article when converting this into GBP, this is approximately £3846.50<sup>4</sup> (05/05/21).

In addition, if an individual has to pay rent, purchase food, clothing and other required goods for themselves and their dependants, then these costs may be deducted from one's wealth. If, after removing these expenses, the remaining amount is less than the Nisab then no Zakat is payable. Remember that Zakat is a duty for Muslims, however the application is fair and balanced based on affordability.

## When to pay your Zakat

Zakat is only due based on when you have passed the qualification for Nisab, this calculation will mean that you are required to pay Zakat within a year from that point. This will become your Zakat anniversary. Your donation will be required a year from this date at the latest, although you could pay earlier if you chose. Once you have paid your Zakat this then becomes your Zakat anniversary. If at any point in a future year you were to fall below the Nisab qualifying amount, the next point where you re-qualify becomes your Zakat anniversary.

# EXCEPTIONS FOR CRYPTO ZAKAT

Whether a cryptocurrency holding is eligible for Zakat is dependent on the nature of the cryptocurrency. There are three distinct types of crypto-assets.

	Definition	Example	Is it applicable for Zakat
<b>Cryptocurrencies</b>	This is the most popular type of crypto. It is treated and can be used as an alternative currency. The value of this type of holding will be impacted by standard demand and supply market conditions.	Bitcoin, Ethereum	<b>Yes</b> – Zakat must be paid on any holdings in their entirety.
<b>Security token</b>	As per the standard security investment process described above, this type of coin is used to support a product. These are subject to Federal laws that govern security <sup>5</sup> .	BCap (Blockchain Capital), SiaFund <sup>6</sup>	<b>Yes</b> – As the application gains popularity, the value of the coin can increase, therefore any value held on this will be applicable to Zakat.
<b>Utility token</b>	Used to pay for internal app purchases for a product or a service, and not for any external resell value.  *Note some tokens can now be exchanged for other cryptos, which can be exchanged for fiat currencies <sup>7</sup> .	FileCoin, SwissBorg token (CHSB) <sup>8</sup>	<b>No</b> – If it used for the purposes of the specific platform services it is not applicable for Zakat.  *If it is transferred out for additional resell value then it is applicable for Zakat.

(Table 1 - Various Crypto-asset Types)

Any accrued losses suffered within crypto investments will be exempt from Zakat payments. For example, if you start out with £1000 investment and due to market activity your holdings at the time of Zakat is valued at £500, you will not be required to pay Zakat unless you liquidate the remaining holdings into cash.

# THE METHODS TO PAY ZAKAT

When the time to pay the Zakat comes, and your holding in Bitcoin has made you a nice tidy profit, the next question is how do I take my cryptocurrency and translate this into a Zakat payment?

The standard approach for paying Zakat on cryptocurrency holdings should be similar to paying it against share holdings and any other investment. The first step is to calculate the amount to pay and then release liquidity on that equity holding to pay Zakat.

Via a cryptocurrency exchange, the seller would release the required capital by selling the number of units to match the Zakat due to be paid. In most cases this would mean cash is liquidated and transferred. However, due to the potential price volatility this may mean that your Zakat will not meet the 2.5 percent requirement. This can be dependent on the specific cryptocurrency held however, an example being the Cardano coin (ticker symbol: ADA) which on the 17<sup>th</sup> of April

2021<sup>9</sup> surged in price by 18 percent in a six-hour period, or Holo coin (ticker symbol: HOT) which had a 22 percent drop<sup>10</sup> over the same period. An alternative method that is now becoming available is to pay Zakat directly in the cryptocurrency held.

Since 2020 there have been various alternatives to pay Zakat due directly using cryptocurrency. However, this has been limited to select exchanges which support this option, or the specific cryptocurrency held and its application to transfer and be liquidated for Zakat purposes.

Organizations such as Blossom Finance in Indonesia will allow the transfer of only Bitcoin and Ethereum coins directly into their charitable wing. This format will be required to support the direct payment of Zakat. This approach has also been adopted by the National Zakat Foundation which accepts both cryptocurrencies as a form of Zakat.

# CONCLUSION

As cryptocurrency becomes more popular, from providers there may be a need for a greater array of Shariah-compliant products and oversight within Islamic finance markets. The number of Muslims holding cryptocurrencies is growing and therefore there is a need to understand how they can pay Zakat on their holdings. When paying Zakat, Muslims will also need to consider their 'Nisab' level and the methods of paying Zakat via their digital investments. As the crypto market continues to grow and mature, traditional financial institutions and Zakat-recipient organizations will need to be proactive with their approach and development of systems for accommodating these types of payments.

The overall need for an effective method to both calculate and pay Zakat on this type of holding will become a more critical aspect of financial management for members of the Muslim community in the future. The current options to pay directly via cryptocurrency holdings using the sites available focus only on Bitcoin and Ethereum. There will be a need to expand this to include the other cryptocurrencies being traded as interest in these alternatives grows. Such solutions will benefit both the individual paying Zakat and the recipient of the Zakat, in terms of speed and application. This will be the next step in the evolution of the Zakat payment possibilities.

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