



Shari'a White Paper on Non-Fungible Tokens (NFTs)

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INTRODUCTION

This Shari'a White Paper on Non-Fungible Tokens (hereafter the "NFTs") is being drafted to divulge our understanding on matters of Shari'a in relation to NFTs. We will try to comprehend and assist in better apprehending how acquiring and dealing in NFTs does not go against the spirit of Islam, considering all the facts and research done for this paper. We shall therefore, guide you through the step-by-step analogy of this paper to conclusively acquiesce in the necessity of allowing digital assets such as NFTs to be accepted.

Subsequently, the content written in this paper is compiled and formulated with the utmost precision and accuracy. The facts stated hereinafter are all backed by credible sources and are free of errors or bias. We shall first begin with explaining the significance of NFTs, what are they, how are they formed, why are they considered to be an asset?

The first ever NFT was minted by a digital artist, Kevin McCoy, it was called 'Quantum' on the name coin blockchain. It was a digital image of a pixilated octagon that changed its color hypnotically and pulsated in a manner reminiscent of an octopus. Following this, a significant amount of experimentation in this arena began, and development of NFTs spruced. The idea behind NFT was to create cryptographic assets which could exist on the blockchain technology, with its unique identification codes and metadata that would distinguish it from others. NFTs can be of different kinds, for example they could represent real world artifacts such as real estate, artwork, documents etc. NFTs can also be obtained to represent an individual's identity, property and rights. The process of assigning NFTs with a unique identification code is called "Tokenisation". Tokenizing these real-world tangibles help in selling, buying and trading NFTs more efficiently and efficaciously, all the while reducing the probability of fraud. It needs to be borne in mind that NFTs are distinct from Cryptocurrencies, since they cannot be traded or exchanged at equivalency, as their value with time can escalate or decline.

It is important to note that since NFTs exist on blockchains, they remove the need for an intermediary and allows the content creators or artists to directly connect with the audience. This in turn simplifies transactions and creates new possibilities in the market. Much of the current market consists of collectibles like artwork, digital art, sports cards, and other rarities cherished by people. These assets surge up to millions of dollars. Nevertheless, this is not indicative of the only things can be converted into NFTs, anything from a contract to a tweet can be made into an NFT, the possibilities in this sector are endless. NFTs have recently been attributed to shifting the crypto paradigm by making each token unique and completely distinct from another ensuring that they are distinguishable and not equal.

Preamble & Objective Statement

While an elaborate discussion on NFTs and their workings has been provided, it is important to discuss how they align with the principles of Islam and are in accordance with the rules of Shari'a in nature and in spirit. This paper shall establish and emphasize on NFTs being shari'a compliant. Different Islamic schools of thoughts and jurists have debated on this matter at length. After much deliberation, they are of the view that an NFT will be considered Halal as long as it shall not represent anything that is unlawful or unislamic in its inception. Simply put, a Muslim shall not procure an NFT as long as it represents certain things, such as images of sacred things which cannot be portrayed otherwise, ridicule or disfigure people, reveals limbs and areas which are to be covered and concealed under the existing shari'a laws. It is critical of gathering collectibles or visual mediums which are negligent of Muslim ummah's sentiments.

Objective Statement:

Non-Fungible Tokens (NFTs) have gained a lot of traction in the recent years. Primarily owing to its expanded use among various sectors and industries this white paper proposes to analyse and answer if NFTs are allowed under shariah law or to that end shariah compliant. Although the idea of tokenization of non-fungibles is new, the concept of fungibles "Mithlyyat" and non-fungibles "Qimiyyat" is not and has been discussed at length under Islamic law. Generally speaking, a fungible (Mithliy) is a property or an asset that is not unique i.e., an identical or near identical asset is available in the market for example money or cars of the same model. A non-fungible (Qimiy) on the other hand, is a property or an asset that is unique or does not have an identical or near identical asset in the same form for example painting or calligraphy.

Therefore, if a fungible item is destroyed by a third party the solution lies in replacing it with a similar product due to its availability. On the contrary if a non-fungible item is destroyed the only remedy lies in the form of monetary compensation due to its unique nature. From the above discussion it can be deduced that to ascertain if an NFT is Shariah compliant, it's the substance of each individual NFT that holds significance.

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NFT`s & their Mechanism

The key Characteristics of all NFT`s include:

- (1) They are cryptographically verifiable,
- (2) They are unique, and
- (3) They are easily transferable. To put it simply NFT`s are like a collector`s item except in digital form.



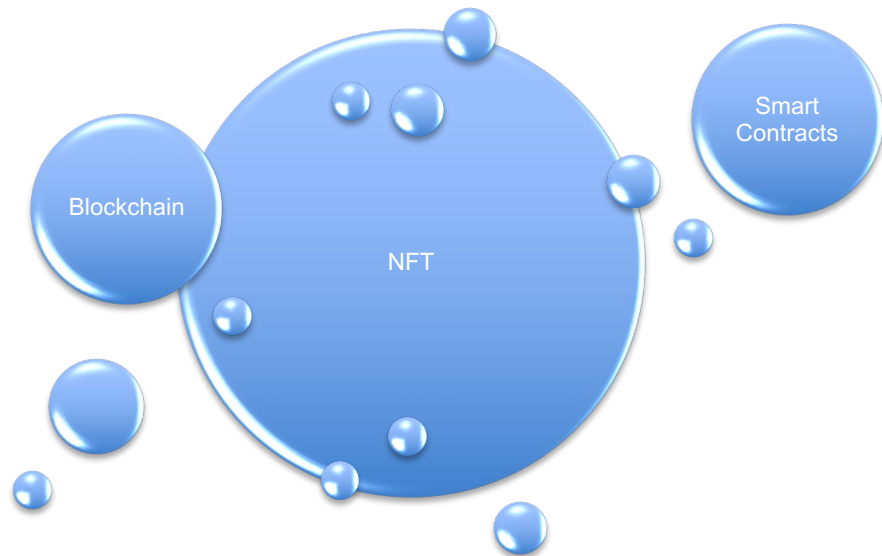
There are two core components that are essential to the existence of an NFT Scheme; Blockchain and smart contract.

02

NFT`s & their Mechanism

The Blockchain acts as a public ledger or database that records transactions on blocks of data that are linked to one another using cryptographic protocols. Once the transaction takes place the data is shared across a set of decentralized computers making it immutable.

A contract is essential to secure the validity and occurrence of any transaction. This is why to facilitate matters for decentralized parties Smart Contracts, a type of predefined contract is brought into use eliminating the need for a third party to guarantee if the terms of the contract have been fulfilled, making the transaction possible.



NFTs are typically held on an Ethereum blockchain, two of its popular standards are:

a) ERC-721

- This was the first standard for NFT's
- It only represents tokens that are non fungible
- Inside every ERC-721 smart contract each NFT has a unique ID or token ID
- The token cannot be changed during the lifetime of a contract
- The code represents the functions of the smart contract under ERC-721
- Creating a new token on the ERC-721 requires implementing a new smart contract making the entire process very costly

NFT`s & their Mechanism

b) Flow NFT Standard:

- This blockchain uses the proof of stake mechanism
- It's unique feature is that it allows upgradeable contracts, as they are deployed in beta state allowing an opportunity for fixing or improving the contract
- in their final stage they become immutable like other smart contracts

A few steps need to be followed before an NFT is uploaded on a blockchain

The NFT must first be digitized, that is, the owner needs to check that the file description and title are completely accurate. After which the raw data is digitized in the proper format

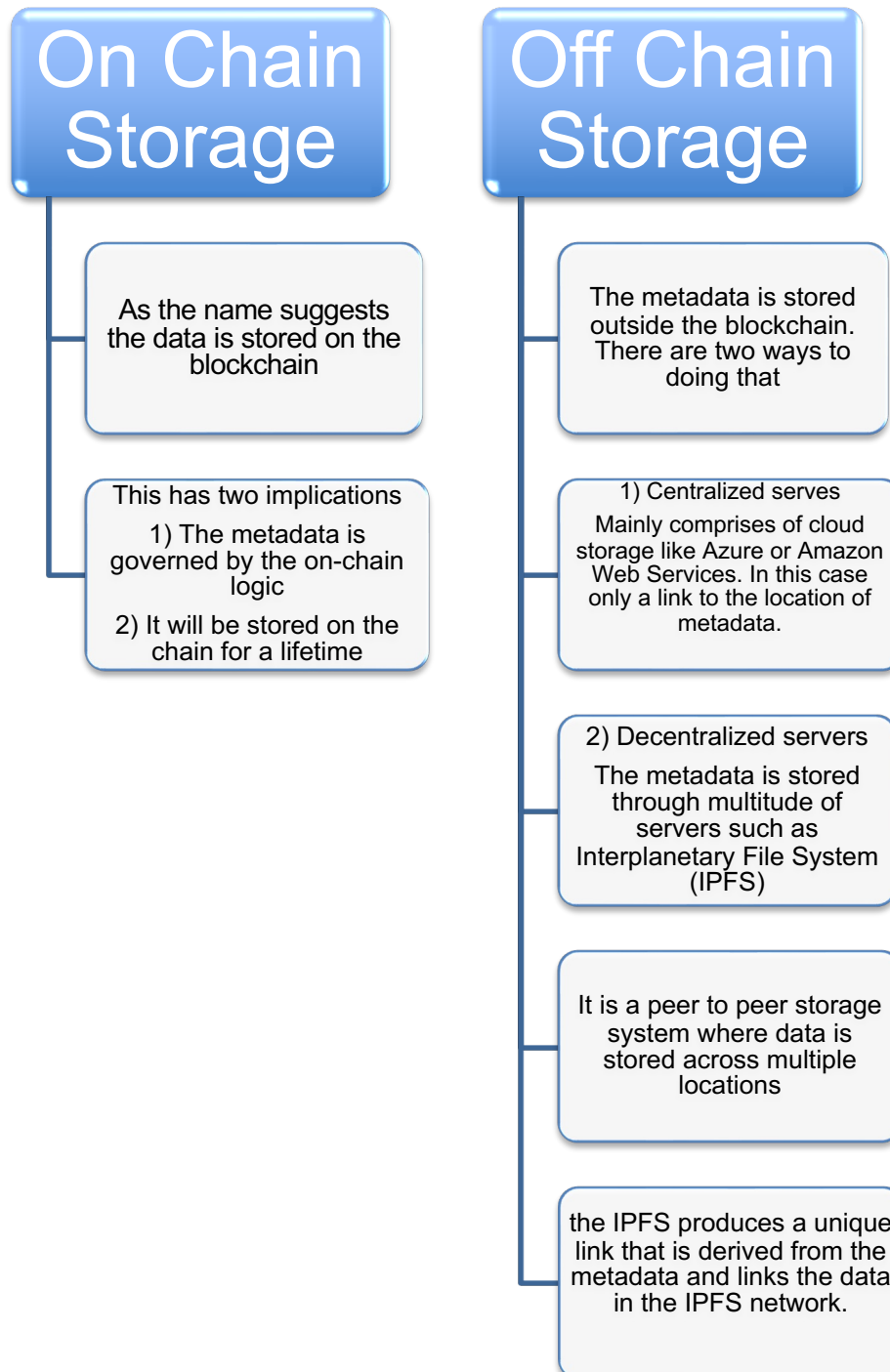
The owner of the NFT stores the data either on a database that is either inside or outside the blockchain

The owner signs the transaction including the hash of the smart contract and sends it to a smart contract

The minting process begins, that functions to check the color code of the specific hex and if it has been minted before. To proceed the color code should not have been minted before

Storage

As a result of the above process a metadata file is produced. That can be stored in the following ways



Shari`ah`s Perspective

Following are the Islamic terminologies which should be considered while discussing NFTs and their trade before getting into the debate of whether NFTs and their trade is halal or haram according to Islamic Rules & Regulations:

1) Al-Baih:

Islam allows parties the freedom to exchange or sell and purchase their properties and services. It only stipulates that people should not take each other's property in an unfair (batil) way. Fairness is a dominant issue in exchange/sale of properties. Unfair (batil) ways include usury, gambling, ambiguities in agreements that can be exploited by the parties, fraud, false measurement, bribery, and theft. The Qur'an commands that properties should be exchanged through trade (tijarah) and with mutual consent (tarad). The Arabic word for sale is Bay', which literally means exchange (mubadalah) and applies to both sale and purchase. Sale can be defined as an exchange of a property for another or as acquisition of ownership over a property in return for a consideration or compensation ('iwad). Sale (Bay') is the most extensively used contract in the market. The effect of a sale contract is to transfer the ownership of the sold property from the seller to the purchaser and the ownership of the price from the purchaser to the seller. The significance of a sale contract could be understood from the fact that, unlike other contracts, the Qur'an specifically refers to it.

'Sale' is defined in Shariah as 'the exchange of a thing of value by another thing of value with mutual consent'. Islamic jurisprudence has laid down enormous rules governing the contract of sale, and the Muslim jurists have written a large number of books, in a number of volumes, to elaborate them in detail. What is meant here is to give a summary of only those rules which are more relevant to the transactions of murabahah as carried out by the financial institutions:

Shari`ah`s Perspective

Rule 1: The subject of sale must be existing at the time of sale.

Rule 2: The subject of sale must be in the ownership of the seller at the time of sale.

Rule 3: The subject of sale must be in the constructive possession of the seller when he sells it to another person.

“Constructive possession” means a situation where the possessor has not taken the delivery of the commodity, yet the commodity has come into his control, and all the rights and liabilities of the commodity are passed on to him, including the risk of its destruction.

Rule 4: The sale must be instant and absolute.

Rule 5: The subject of sale must be a property of value.

Rule 6: The subject of sale should not be a thing which is not used except for a haram purpose, like pork, wine etc.

Rule 7: The subject of sale must be specifically known and identified to the buyer.

Rule 8: The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

Rule 9: The certainty of price is a necessary condition for the validity of a sale. If the price is uncertain, the sale is void.

Rule 10: The sale must be unconditional. A conditional sale is invalid, unless the condition is recognized as a part of the transaction according to the usage of trade.

As stated by Prophet Muhammad SAW:

نَهَى النَّبِيُّ صَلَّى اللهُ عَلَيْهِ وَسَلَّمَ عَنِ النَّجْشِ

“The Prophet shallallahu ‘alaihi wa sallam forbids from buying and selling najasy.” (Hadith Bukhari no. 2142 and Muslim no 1516)

Stated by Prophet Muhammad SAW at another instance:

إِنَّ اللَّهَ وَرَسُولَهُ حَرَّمَ بَيْعَ الْخَمْرِ وَالْمَيْتَةِ وَالْخِنْزِيرِ وَالْأَصْنَامِ « . فَقِيلَ يَا رَسُولَ اللَّهِ ، أَرَأَيْتَ شُحُومَ الْمَيْتَةِ فَإِنَّهَا يُطْلَى بِهَا السُّفُنُ ، وَيُدْهَنُ بِهَا الْجُلُودُ ، وَيَسْتَنْصَبُ بِهَا النَّاسُ . فَقَالَ « لَأَ ، هُوَ حَرَامٌ » . ثُمَّ قَالَ رَسُولُ اللَّهِ – صَلَّى اللهُ عَلَيْهِ وَسَلَّمَ – « عِنْدَ ذَلِكَ « قَاتِلِ اللهُ الْيَهُودَ ، إِنَّ اللهَ لَمَّا حَرَّمَ شُحُومَهَا جَمَلُوهُ ثُمَّ بَاعُوه فَأَكَلُوا ثَمَنَهُ

“Indeed, Allah and His Prophet forbids buying and selling khamar, carrion, pigs and statues.” Someone asked, “O Rasulallah, what do you think about buying and selling carrion fat, considering that the carrion fat is used to patch the boat, oiling skin, and become oil for lighting?” The Prophet shallallahu ‘alaihi wa sallam said, “You can’t! Buying and selling the carrion fat is forbidden.” Then, the Prophet shallallahu ‘alaihi wa sallam said, “May Allah curses Jews. Indeed, when Allah forbidden the carrion fat, they melted it then sold the oil of the carrion fat, then they ate the sale outcome.” (Hadith Bukhari no.

2236 and Muslim, no. 4132)

Shari`ah`s Perspective

Another rule of Islam which describes the rule for transaction of the trade:

الايجاب هو ما دل على التمليك دلالة ظاهرة، والقبول هو ما دل على التملك كذلك

“Ijab is a proof that shows the surrender with a clear proof (can be accounted for), meanwhile qabul is a proof that shows the acceptance.”

2) Israf

Extravagance or Israf means spending more than your means – which means that Extravagance is relative and not something we can put a limit/number on.

Being extravagant is also spending on anything that you don't need. Being wasteful is owning anything that is not a necessity.

إِنَّهَا سَاءَتْ مُسْتَقَرًّا وَمُقَامًا

Indeed, it is evil as a settlement and residence.”

وَالَّذِينَ إِذَا أَنْفَقُوا لَمْ يُسْرِفُوا وَلَمْ يَقْتُرُوا وَكَانَ بَيْنَ ذَلِكَ قَوَامًا

And [they are] those who, when they spend, do so not excessively or sparingly but are, between that, [justly] moderate.

(AlQuran 25:66-67)

يُنَبِّئُ عَادَمَ خُذُوا زِينَتَكُمْ عِنْدَ كُلِّ مَسْجِدٍ وَكُلُوا وَاشْرَبُوا وَلَا تُسْرِفُوا إِنَّهُ لَا يُحِبُّ الْمُسْرِفِينَ

O children of Adam, take your adornment at every masjid, and eat and drink, but be not excessive. Indeed, He likes not those who commit excess.

(AlQuran 7:31)

NFT & Islam

NFTs are digital assets, each asset has its own value defined by the person who owns it under a unique identification number. NFTs are sold through bidding and when a perfect price is given it is sold with all its rights to the purchaser and that unique identification address is transferred by seller to purchaser. This procedure of trading is allowed in Islam and the limitation of the trading procedure is mentioned above. None of the Islamic limitation described above in the Baih part is being violated during the trading of NFTs.

Furthermore, Islam doesn't allow a person to spend money on useless products, which comes under the domain of 'israf'. This requirement should be kept in mind while trading NFTs.

As discussed earlier, NFTs are like other assets but the difference is that they are not physical in nature but are rather digital in form, however, the mechanism for trading both types of assets remain the same. Therefore, the mechanism for trading NFTs does not challenge the limitations of Islamic rules. Like other assets, NFTs are created, owned and possessed by a person after which they are sold to any other customer who is willing to purchase it on specific quoted amount and afterwards all the rights related to NFT are transferred to the purchaser. In this way the whole transaction takes place and all that transaction is in accordance with the Islamic rules.

Islam advocates for development and adopting to the changing world and NFTs are one such example of the changing times. The World is transforming into a digital Globe and so are the assets. A large amount of people has already adapted this form of assets and so the Muslim world is also encouraged to adapt it on the basis of the following Islamic Legal Maxim:

There are different Islamic maxims available which pave the path towards the advancement and acceptance of new technologies. One of the Islamic legal maxims that encourage accepting products such as NFTs is:

“Necessity renders prohibited things permissible”.
(Majalah, No.21)

The details of the above mentioned Islamic legal maxim can be found in 'Ahkaam ul Sarf'. Another leading Islamic legal maxim states:

“Permissibility is the original state of things”
(Details of this maxim can be found in istishab)

NFT & Islam

In the light of above stated Islamic maxims it can easily be deduced that it has become one of that necessity of the Islamic World to consider trading NFT as halal because almost all the people around the globe are already trading or owning some NFTs and therefore, to provide an equal opportunity to Muslims we need to address this issue at the earliest for the benefit of Muslims at large. On the other hand, the principle that is used the most in Fiqh is “Istishab” which means that the original rule for all things is permissibility. The presumption is that all items are permitted unless prohibited by Islamic Law. The principle of istishab was accepted by Imam Al Shafi’i and some of its types by the Hanafis such as Al-Karkhi and Al-Sarakhsi. It is commonly accepted that Islamic Law furthers the interest of human beings (maslahah). These interests may modify in different circumstances. There is no doubt that this principle should be treaded upon carefully. Fully acknowledging the fact that there wasn’t any prohibition regarding the NFTs has been proven to be a beneficial asset for everyone without challenging the limitations of Islam, it can be legalized within the domain of Islamic law upon the bases of rule of Istishab.



Conclusion

NFT is a latest technology which is bringing a revolution in the world of Web 3.0 and digital assets. Islam never discourage the development in the field of technology & advancement. The mechanism and described procedure for trading NFTs does not involve any kind of element which deems NFTs as haram. NFTs should be encouraged in such a way that only halal NFTs should be allowed to be traded within the Islamic World to provide opportunity to the Muslims to enjoy the same perks of technology as the other people around the Globe are enjoying. Adding more there should be a regulatory body which should be governed by a board of Islamic Scholars who can further declare which NFT can be traded on the grounds of the limitations defined in Islam for trading.