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Estate Planning Amidst the Growth of Cryptocurrency Wealth

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Background: Blockchain

- Technology that stores information in blocks that are linked together in chronological order
- Most commonly used as a ledger for transactions
- Managed by a peer-to-peer network
- Decentralized management prevents alteration of the records; data is immutable and irreversible

Background: Cryptocurrency

- Digital currency that exists on Blockchain
- Used to purchase goods and services and held, bought, and sold for investment

Cryptocurrency Today*

- More than 10,000 different cryptocurrencies are publicly traded
- Over 68 million users of cryptocurrency
- Total value of all cryptocurrencies on August 18, 2021 over $1.9 trillion

*Source: CoinMarketCap.com

Cryptocurrency Wallet

- Allows user to send and receive cryptocurrency
- Accessed using public and private keys (alphanumeric codes)
- Public key functions as an address to allow transfers in
- Private key controls access to cryptocurrency in wallet
- Can be held online or offline (“cold storage”)

Cryptocurrency: Basic Tax Considerations

- Treated as property (not currency) for United States tax purposes
- FMV demined by converting into U.S. dollars at current exchange rate
- Gain or loss recognized when cryptocurrency transferred for consideration that is higher or lower than basis
- Value of cryptocurrency owned by decedent must be reported on estate tax return

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Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA)

- Federal Stored Communications Act and Computer Fraud and Abuse Act (which protect privacy and combat hacking) limit an executor or trustee's ability to lawfully access a decedent's digital assets

- RUFADAA allows fiduciaries to access, copy, and manage certain digital assets

- Texas Estates Code Chapter 2001

- Practice Point: Owners of cryptocurrency must give affirmative written consent to executor/trustee in order for RUFADAA to apply

Estate Planning Challenges

- Heirs, executor, trustee might not know decedent owned cryptocurrency
- Difficult asset to marshal
- All cryptocurrency transfers require public and private keys
- Highly volatile asset

Record-Keeping and Marshaling

- Document ownership of cryptocurrency.
- Document where cryptocurrency is stored.
- Document Public and Private keys.
- <u>Practice Point</u>: Parcel out information among multiple parties so that no person acting alone has the ability to access cryptocurrency.

Public and Private Keys

- Create a document with necessary information and update regularly.
- Store document (or instructions for accessing document) in a safe deposit box or other secure location accessible to executor, trustee, or personal representative at time of death or incapacity.
- <u>Practice Point</u>: Do NOT include information in wills, powers of attorney, or other documents that might become public.

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"Dead Man's Switch" (Offered by Zabo) *

- Transfers cryptocurrency automatically if owner does not log in within a certain time or fails to respond to a communication within a certain time period.

- Can be structured to transfer "specific instructions, such as where to find a private key or where a hardware wallet is stored."

**See* https://zabo.com/bog/azbo-kubera-crypto-dead-mans-switch/

Volatility

- Owners of cryptocurrency should consider a trust or other plan that circumvents probate, to avoid delays in marshaling, managing, and disposing of cryptocurrency.

- Executors and trustees should consider converting cryptocurrency into less volatile assets.

- Owners of cryptocurrency should consider naming a special-purpose executor or trustee with knowledge and ability to manage these assets.*

*Conrad Teitell, Heather J. Rhoades & Katherine A. McAllister, *Cryptocurrency – Estate and Charitable Planning and Compliance*, TRUSTS & ESTATES, (January 2019), at 44.

Volatility

- Estate that would not be taxable at time will is drafted may be taxable at time of death.
- Specific gifts may have vastly different value at time of drafting compared to date of death.

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Trust Planning

- Option 1: Transfer cryptocurrency to wallet owned by Trustee
- Option 2: Transfer keys to Trustee and memorialize transfer in writing

Liability Risk for Fiduciaries

- Unclear whether holding cryptocurrency satisfies “reasonable person” standard.

- Practice Point: Consider including in trust or will language that gives trustee or executor the specific authority to hold cryptocurrency.

- To provide protection under RUFDAA, include language that gives trustee or executor access to computers, other hardware, and login information.

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Charitable Planning Considerations

- To ascertain value of charitable contribution deduction, consider whether gain would be long-term capital gain if cryptocurrency were disposed of by sale or exchange and tax-status of beneficiary organization.
- Deduction for contribution of property in excess of $500 requires Form 8283, signed by donee.
- Deduction for contribution of property in excess of $5,000 requires qualified appraisal.

Charitable Planning Considerations

In addition to customary diligence, consider donee’s ability to safeguard and manage cryptocurrency.

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Charitable Planning with CRT

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- Allows donor to obtain immediate charitable contribution deduction and retain (or gift) an annuity interest or unitrust interest.

- NICRUT or NIMCRUT PAYS donor the *lesser* of trust income or percentage of trust corpus valued annually and addresses uncertainty of future trust income or ability to sell assets.*

* Conrad Teitell, Heather J. Rhoades & Katherine A. McAllister, *Cryptocurrency – Estate and Charitable Planning and Compliance*, TRUSTS & ESTATES, (January 2019), at 44.

Cryptocurrency and Private Foundations

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- Cryptocurrency acquired by purchase may be a "jeopardizing investment".
- Sale of debt-financed cryptocurrency gives rise to unrelated business taxable income.
- Consider effect of volatility on annual minimum distribution requirement.