Don't Lose Your Wallet!

Five Things To Know About Estate Planning With Cryptocurrency

By Shaina Kamen, Esq., Holland & Knight LLP, Miami, Florida, and New York, New York

With more than 15 percent of adult Americans (approximately 40 million people) investing in, trading, and using cryptocurrencies, cryptocurrency is no longer a niche alternative investment solely for those in the know.[1] As cryptocurrency has entered the mainstream, existing financial institutions and new-to-market custodians provide consumers opportunities to invest in this emerging asset class.

continued, page 11

As interest in this asset class grows, planners should consider how these assets can be accessed and disposed of in the event of the holder's incapacity or death. In a typical estate administration, a court appoints the nominated Personal Representative, who is tasked with marshaling decedent's assets. The Personal Representative can identify the decedent's assets by reviewing account statements for known accounts or, if unknown, by providing the decedent's Social Security number to the financial institution and asking that accounts associated with the number be identified. Once the Personal Representative locates the account, the Personal Representative presents Letters of Administration to the institution. The financial institution distributes the assets, whether cash or marketable securities, in accordance with instructions provided by the fiduciary. If instead, the account has a payable on death beneficiary designation, the beneficiary can go directly to the institution with a copy of the death certificate to collect the contents of the account.

In contrast, cryptocurrency holdings, often cloaked in anonymity, can be difficult to identify and collect. Cryptocurrency transactions are recorded on the blockchain, which is effectively a database of transactions available for public view. Individual transactions are secured on the blockchain through a digital verification process. These public and private keys are often stored in "wallets," which can be "hot," "cold," "digital," or otherwise. Cryptocurrency may also be held in an exchange or by certain financial institutions.

Depending upon how the cryptocurrency is held, distribution upon the holder's death may not necessarily proceed in such an orderly manner. Although cryptocurrency held by a financial institution may be accessed by a fiduciary in the same manner as cash or securities, cryptocurrency held in a "wallet" cannot be accessed without overcoming the account's security. For this reason, cryptocurrency poses a significant risk of becoming lost or inaccessible upon the death of the account holder, even for the sophisticated investor. For example, an heir to the fortune of a large international financial institution died without leaving his fiduciaries or heirs access to an estimated $500 million in cryptocurrency. Without reference to cryptocurrency in the planning documents and "cold wallets," or wallets not connected to the internet, stored throughout the country, the process reportedly significantly hampered the administration of the estate.

As cryptocurrency becomes more mainstream, planners should take an active role in facilitating planning with this asset. A discussion of some basic planning considerations for cryptocurrency follows.

Identify Digital Assets.

It is critical to address cryptocurrency, non-fungible tokens (NFTs), and other digital assets as part of the estate planning engagement. Because individuals often store cryptocurrencies in a digital wallet secured and accessed only through a private key, there is no personal identifying information associated with the asset. If the assets are not specifically disclosed or known, the assets may simply die with the decedent. Moreover, if the password is held by a family member or friend, the asset may not be disposed of in accordance with the decedent's estate plan. Planners should ask their clients if they hold cryptocurrency, how and where these assets are held, and how to access the assets. Not only will this aid the Personal Representative or Trustee to identify and marshal these assets after the death of the decedent, but information about these assets may need to be disclosed in court filings, such as estate inventories, or reported on federal estate tax returns and related filings.[2]

Because cryptocurrency poses unique issues in an administration, identifying cryptocurrency as an asset also provides an opportunity for the planner to tailor the plan to facilitate the administration and management of these assets, discussed in greater detail below.

Facilitate Fiduciary's Access in the Event of Incapacity or Death.

During the client's lifetime, the private key controls the ability to transfer cryptocurrency secured by the blockchain. After death, the fiduciary must have access to the private key. If the key is lost, there is no way to recover it to gain access.

In the absence of planning, there is little infrastructure in place to facilitate the orderly transition or succession of cryptocurrency in an estate administration. While a majority of states, including Florida, have adopted an iteration of the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA) – in Florida, the Florida Fiduciary Access to Digital Assets Act – to address access to digital assets following the death of the account holder, most cryptocurrency does not fall within the definition of a "digital asset." Although RUFADAA may provide a fiduciary with access to an account custodian, under current law fiduciaries may be without recourse if access to blockchain holdings held directly is lost at the decedent's death.

The estate plan should provide a mechanism for a secure transfer of the private key to fiduciaries or beneficiaries. Although solutions will emerge as cryptocurrency becomes more mainstream, current thoughts include providing instructions to the fiduciary, to be held in escrow until the incapacity or death of the client, or even a "switch" that transfers the cryptocurrency upon the occurrence of a designated event such as death.

Consider Fiduciary Selection.

Because cryptocurrency is a highly volatile asset with distinct

continued, page 12

security considerations, the client should give consideration to fiduciary selection where it is anticipated that cryptocurrency will be a future asset of an estate or trust. For example, a surviving spouse who is inexperienced in this area may not be the best choice to manage such assets. Moreover, the nominated fiduciary could also be uncomfortable with administering an asset of this nature and decline to serve altogether. For this reason, depending on the magnitude of the cryptocurrency holdings, the client may wish to name one or more individuals to specifically manage these assets along the lines of a "special holdings" personal representative or trustee.

Estate Planning with Digital Assets

- ✓ **Identify all digital assets**
- ✓ **Facilitate fiduciary's access in the event of incapacity or death**
- ✓ **Consider fiduciary selection**
- ✓ **Address cryptocurrency in planning documents**
- ✓ **Don't "discount" lifetime strategies**

Further, a fiduciary bears responsibility for managing and investing the assets of an estate or trust. Cryptocurrency, which poses a significant risk, may be outside the realm of an investment under the Florida Prudent Investor Rule. The planning documents should address and minimize the fiduciary's personal liability associated with retaining these holdings, including specific authority to retain or sell these assets and guidance as to its continued management and investment. If specific authority is not included in the planning documents, the fiduciary may be required to sell the assets to comply with fiduciary duties owed to the beneficiaries. Different strategies may be pursued if the asset is to be held short-term or for a longer duration as part of a dynasty trust.

Address Cryptocurrency in Planning Documents.

Clients should disclose cryptocurrency in the estate planning documents and specifically address the disposition of these assets to make sure that the assets are disposed of to minimize roadblocks in administration. For example, assignments of cryptocurrency to revocable trusts should be documented to avoid complexities in dealing with cryptocurrency as a probate asset in states such as Florida, where the use of restricted depositories may be common.

For clients who intend to hold this asset class in the long term, the planner should be sure to include specific instructions in the planning documents. For example, cryptocurrency, a highly volatile investment, may not be a desirable asset of a marital trust for the benefit of the surviving spouse if the estate also includes more stable income-producing assets to use for this purpose.

Don't Discount Lifetime Strategies.

Finally, individuals who wish to avail themselves of the benefit of the sky-high federal and gift tax exemptions (currently $12.06 million per individual as of January 1, 2022) may wish to engage in lifetime planning strategies, such as transfers to grantor trusts, with these assets. Cryptocurrency held in structures such as limited liability companies (LLCs), which may bolster creditor protection, are ideal candidates for transfer because it is far easier to transfer the entity interest rather than the underlying asset. Transfers of interests in an entity may be subject to valuation discounts for minority interests or lack of marketability upon transfer to family wealth planning structures. Because of the potential for appreciation, these special assets may be good candidates for transfers to dynastic trusts.

Planners should discuss with clients the short- and long-term goals of owning these assets and tailor planning accordingly. Cryptocurrency is subject to federal tax on capital gains and net investment income tax. State tax considerations may apply as well. For clients with significant holdings, some consideration should be given to domicile planning to a more tax-favorable jurisdiction ahead of any anticipated liquidity events.

S. KAMEN

***Shaina Kamen** is a partner at Holland & Knight LLP. Ms. Kamen graduated from Syracuse University College of Law and received her L.L.M in Taxation from Georgetown University Law Center. Ms. Kamen is a member of The Florida Bar and a Fellow of the American College of Trust and Estate Counsel (ACTEC). She is also admitted to practice law in New York.*

Endnotes

1 https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/09/fact-sheet-president-biden-to-sign-executive-order-on-ensuring-responsible-innovation-in-digital-assets/ (last visited May 6, 2022)

2 The IRS treats cryptocurrency as property for federal tax purposes. Cryptocurrency, therefore, should be subject to a step-up in basis at the death of its owner.