

**Lex Mundi Blockchain White Paper Series**

# Estate Planning for Cryptocurrency Doesn't Need to be Cryptic

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Cryptocurrency exchanges are on the rise making investing in digital currencies easy and accessible to investors of all types, ages, and wealth status. It is estimated that over USD700 billion worth of cryptocurrency spans the global economy. Advisors and investors should take immediate steps to plan for the impact of cryptocurrency on an investor's overall estate plan, and ensure such wealth isn't lost in cyberspace upon incapacity or death of an investor.

## Beauty is in the Eye of the Keyholder

Cryptocurrency is digital currency that uses encryption and links peer computers all over the world to validate transactions. Investors download software and create accounts within each brand of virtual currency (e.g., Bitcoin), allowing the investor to access the network and join peer-to-peer exchanges of information to legitimize the global ledger. Investors can then purchase the virtual currency from online exchanges and hold the virtual currency in their virtual wallet – accessible by an encrypted “private key” anywhere around the world at any time. This decentralization and the use of global, anonymous, and multiple peer validation processes appeals to investors looking for alternatives to traditional government-backed banking systems susceptible to government intrusion, the political and economic climate of specific countries, or hackers.

However, a digital wallet worth USD1 billion (or any other number) without the private key is useless. There is no “change password” option, no 1-800 number to call, and no recourse against a digital currency exchange to recover a lost key. Sudden death or incapacity without proper planning can render an investor's digital wealth worthless instantaneously.

## Plan, plan, plan

Revocable trusts remain a common tool to hold a person's assets and direct the disposition of such assets at death and avoid probate administration. Trusts can also increase tax efficiency and allow for greater privacy, control, and flexibility – characteristics valuable to most investors.

To fund the trust, the investor should sufficiently identify, title, and/or assign the digital currency to the trust. Such action can avoid probate administration of the digital currency and alert beneficiaries and fiduciaries to the existence of such assets. However, a probated will is open to public inspection and a trust, while theoretically more private than a will, can still be the subject of public probate processes. Thus, only enough information to identify the digital currency as an asset of the trust should be included. Private keys should never be listed in the estate planning documents.

A separate memo containing detailed information for cryptocurrency, exchange accounts, digital wallets, etc. including private keys, usernames, PINs, passwords, and security codes, or information regarding an alternative secure digital archive storing such information and access instructions, should be easily accessible by a fiduciary when the need comes. Such a memo can be stored in a safe deposit box or another secure location.

There has been increasing movement to biometric wallets to increase security, but additional analysis should be undertaken to determine whether the contingency of death is covered and whether the cryptocurrency can be accessed through a secondary or tertiary holder or other means (since the primary biometrics likely cannot be duplicated after death).

### **Entrusting the Trustee with the Digital Wallet**

Given the complexities of cryptocurrency, careful consideration should be given to the selection of trustee: is the trustee capable of administering, liquidating, trading, retaining, or transferring the cryptocurrency to or for the benefit of the investor or the beneficiaries? Many professional fiduciaries have policies against administering trusts with digital currency and/or demand immediate liquidation of such assets. Thus, investors should research and interview potential fiduciaries prior to appointment. Vetted alternatives should be chosen, should the first choice be unable or unwilling to accept the appointment.

If the investor intends for the cryptocurrency to be retained, provisions permitting such investments must be added to the trust. Most states, including California, have laws on how a trustee must invest trust assets, including a duty to diversify and act as a prudent investor, absent other instructions in the trust instrument. Given the novelty of cryptocurrency and the potential for such assets to represent a large part of the trust portfolio, cryptocurrency investments may be deemed too speculative or render the portfolio insufficiently diverse. Additional language should be added to the trust granting the trustee discretion to retain, buy, sell, and trade cryptocurrency, relieving the fiduciary of the duty to diversify or prudently invest, and holding the fiduciary harmless for good faith decisions concerning digital currencies.

Several states, including California, have adopted some form of the Uniform Fiduciary Access to Digital Assets Act (UFADAA). In general, the UFADAA allows an individual to appoint a “digital fiduciary” to have authority to access certain digital assets if certain conditions are satisfied. An attorney should be consulted to determine whether the state the investor lives in has adopted the UFADAA and to ensure the investor’s estate planning documents meet the requirements of the UFADAA. Consideration should also be given to the use of a “Cryptocurrency Advisor” to specifically advise on such assets.

From a fiduciary perspective, no trust should be accepted prior to review and confirmation that the provisions meet the fiduciary’s policies. Fiduciaries should attempt to be involved early in the planning to mitigate drafting issues with respect to cryptocurrency. Alternatively, the fiduciary should consider the use of decanting statutes, notices of proposed actions, and petitions for instruction as tools for reducing liability to the fiduciary.

### **Tension with the Unintended Beneficiary**

Pursuant to IRS Notice 2014-21, the IRS does not treat cryptocurrency as “currency”, but rather as “tangible property” for federal tax purposes. However, state property law may vary, treating the asset as either intangible or tangible property. How the asset is defined for state law purposes could have a large effect on the disposition of cryptocurrency if not properly accounted for. Traditionally, tangible personal property is thought to include used furniture, clothing, and other potentially low value assets, and may be given little attention in estate

planning documents. Given the potential for highly appreciated cryptocurrency, close attention must be given to ensure cryptocurrency passes to the intended beneficiaries, and in the manner intended. For example, perhaps an eighteen-year-old beneficiary should not inherit USD2 million of appreciated cryptocurrency outright and free of trust along with the decedent's used shoes?

US citizen and US domiciliary decedents are subject to federal estate tax at a rate of 40% on the decedent's worldwide assets in excess of their remaining exemption from estate/gift tax (approximately USD11.18 million in 2018), after accounting for relevant deductions. It is important to evaluate whether inclusion of cryptocurrency in the estate will result in estate tax, making the government a likely unintended beneficiary of the digital currency! Many advanced planning opportunities exist for high net worth investors to shift the wealth to intended beneficiaries and out of the government's hands.

### **Lions and Tigers and Bitcoin, Oh My!**

Advisors need to address cryptocurrency assets head on with their investor and fiduciary clients. Proactively implementing an estate plan for the investor or policies for fiduciaries addressing the unique nature of cryptocurrency assets can mitigate the risk of losing the investment upon incapacity or death of the investor, potentially reduce estate taxes, and provide a platform for the seamless administration and long-term distribution of the assets.

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