TRANSCRIPT:

Mary: Welcome to today's episode of Vandenack Weaver, Truhlsen law visionaries, a weekly podcast discussing updated legal news, as well as evolving methods of providing legal service. My name is Mary Vandenack I am CEO, founding and managing partner of Vandenack Weaver, Truhlsen LLC and I will be your host. As we talk to experts from around the country about closely held businesses, tax trusts, estates, legal technology, law firm, leadership, law, practice management, and wellbeing.

Mary: On today's episode. My guest is Lara Sass. Lara is an estate planning attorney in New York city serving high net worth clientele. Today, we are going to talk about cryptocurrency in estate planning. You can also hear Lara on previous episodes where she spoke about family limited partnerships, dynasty trusts, and section 1202 strategies. Welcome back, Laura.

Lara: Thank you, Mary, for having me. It's always a pleasure to chat with you on the podcast.

Mary: Well, I really appreciate you joining us today. We're going to discuss a really hot topic recently, cryptocurrency and estate planning. We could assume that everyone knows what cryptocurrency is, but I'd be really appreciative if you could start with an explanation.

Lara: Sure. I will try to keep it as simple as possible. So, cryptocurrency is a digital asset that is created and traded online using encryption minors, who are essentially computer operators, establish new units of digital currency and record them on what is called a blockchain, which is a string of verified public transaction records. Cryptocurrency records are public, but the identity of the holder is private. Virtual money is traded on exchanges, such as Coinbase, Kraken, and crypto.com and a transaction involves the exchange of wallet numbers only no names. There are two primary ways to own a cryptocurrency account through a wallet on a cryptocurrency exchange, such as the ones that I mentioned or in your own wallet with an encrypted, private key, a hot wallet as it is called, is connected to the internet and could be vulnerable to online attacks. Whereas what is called a cold wallet is typically not connected to the internet and could be a more secure method of storage.

There are thousands of types of cryptocurrencies, as you know, the most well-known ones are Bitcoin Ethereum, light coin, doge coin, and Cardo ever increasingly cryptocurrencies can be used to purchase tangible items. So, you may have heard the big news when Elon Musk announce that Tesla's supercharging station will accept doge coin as payment. In addition, now, PayPal and Venmo allow users to buy and hold cryptocurrency in their digital wallets.

Mary: I have to mention, and it's been a while now, so I don't even remember what year, but my home state is Nebraska, and this state was one of the first ones that allowed legal fees to be paid with cryptocurrency.

Lara: Oh wow. Wow.

Mary: We don't, we actually don't accept that yet, but you know, we are like having conversations about whether we should be looking at it,

Lara: I'm doing the same.

Mary: So why should cryptocurrency be considered in the estate planning process?

Lara: So when individuals sit down to discuss their estate plans with us, they typically think of the traditional assets first, such as their home bank and brokerage accounts, retirement accounts, investments, business interests, et cetera, but for an increasingly large number of people, digital assets, such as cryptocurrencies, as well as NFTs, which are non-fungible tokens are becoming just as important. Furthermore, unlike traditional assets, there is no physical manifestation of cryptocurrency. So, failing to include it as part of your estate plan could be far more detrimental than neglecting to plan for those more traditional assets.

Mary: So, in the cryptocurrency realm, we have kind of this, you can't really see it. So people don't think about it, but it can have significant value in their estate plans and it's also, if you don't plan for it, one of those assets, let's say it's a small amount and I always make jokes because a lot of we have over the years, it's always been people buying oil interest in Texas and it can cost more to get out from under the oil interest in taxes, then the assets actually worth and you can't really avoid the probate, but can you avoid probate with crypto assets held on an exchange? Can you use beneficiary designations TODs?

Lara: So crypto exchanges are similar to traditional brokerages in that a custodian holds the account. Unfortunately, right now most exchanges don't allow for beneficiary designations or even ownership by a trust or business entity, which can make traditional estate planning difficult. Another downside is that if an account does increase significantly in value, which as you know, can happen really quickly with crypto as well as the reverse, but only so much can be withdrawn from the exchange on a daily basis, thereby limiting immediate access to the assets, probate administration, although traditionally undesirable will hopefully ensure that crypto accounts aren't lost upon the owner's death.

Mary: So, if you own some crypto, where is the probate? Is the probate going to be state of resident of the decedent? Where is it considered to be located?

Lara: So, it will be likely state of residents of the decedent and part of their general probate process.

Mary: Which is usually the case for intangible personal property, right? Is that I know that IRS that's

Lara: Exactly right.

Mary: And so, is that how the IRS is classifying crypto as property? Is it being classified as the intangible? I I'm assuming yes

Lara: It is. It is the IRS considers it property and not currency actually.

Mary: Okay

Lara: It's tax according to those same rules.

Mary: And so that is gonna be now can the states vary on this in terms of the probate issue or is what the IRS treats it as gonna control that?

Lara: You know, all of this is in so much flux and the laws continue to develop. So, I, I think, you know, for right now it's gonna be in the state of residency, but as laws change, you know, that may change as well.

Mary: So, pay close attention to the crypto rules because that's exactly right. For sure. I think you're exactly right. That it'll be a change a minute. So, to the extent that that's the case, then how do heirs access the assets?

Lara: So, for crypto accounts that are not on an exchange, each account is accessible by an encrypted private key and a key can be as long as 64 digits and it's unique to every single owner when an owner signs up or purchases a wallet, he or she will receive a unique key. That must be entered in an exact order in order to access that wallet. If the key is lost, there is no password reset or court order in the world that could possibly recover the key. So, the account and all of its value will be gone forever. I'm sure you've heard about Matthew Mellon who is heired to the Mellon fortune who died without passing along his key information on his $1 billion crypto account or James Howells who mistakenly threw away a hard drive containing access to over access to over $300 million of Bitcoin and has literally been searching landfills for years to track it down of the existing 18.5 million Bitcoin around 20%, which is a worth of about 140 billion appears to be lost or otherwise stranded in wallets. So, the bottom line for crypto held by the owner alone and not in an exchange is that loved ones must know one that the account exists in the first place, two where to find it and three how to access it via private key.

Mary: So, I was thinking about this, discussing this, and it was this $300 million of missing Bitcoin and how that work if he ever went through his entire fortune was subject to a spend down and with the government somehow have access to that, which I'm not really asking. It was just a thought I was having going well, there's a whole lot of issues with crypto that we're gonna see at some point as estate planners. So, one of the things that I was just noting, like when you talk about this private key, so somebody can use the private key after death. So, let's say that I go and I have this crypto and I have a wallet. I have my key. So, like with passwords in certain cases, it's actually criminal to use the password after somebody's passed away or is disabled. That's not the case with the key in the crypto world.

Lara: Yes. Again, welcome to like the funky world of crypto, right? And in this situation with crypto, the key is your only way to access it and it's fully legal to be able to access it, using that as opposed to using a password for more traditional accounts.

Mary: So, it's sort of like if I give someone a key to my house and they use it and then they take everything out, that's too bad.

Lara: Right. That that's correct.

Mary: So, what is state planning techniques do you recommend to minimize the risks that a valuable crypto crypto account is lost to theft or death?

Lara: So, there are a number of different measures that I typically recommend to clients and it, it depends on their preferences and what their objectives are, but I'll summarize some of them as a first measure, they can consider sharing the account information, including the private key with a spouse or a trusted family member advisor, or a friend it's important to remember, as you said, with the key to the house, that when you select appropriate holders of this information, treat it like cash because access to the key itself is all the person needs to access the account, move the assets and claim it as their own. For some, it might be better to include this information in a memo, locked away in a safe deposit box or other secure location where the trusted family member or friend will know how to access it when the time comes. If your family members or intended beneficiaries are not familiar with the workings of crypto accounts, it's best to provide them with a step-by-step guide, to access and administer the crypto. As a second measure, I would consider splitting the private key amongst a few different trusted individuals. So perhaps your attorney holds half the key, and your accountant holds the other half, but an arrangement should be entered into with both as to when and how the information is disseminated upon your death and as to what storage mechanism each can offer.

Mary: Okay, let's continue our episode. So let me ask you a question before you give the next solution. So, once you have the key, can you ever change it? Like if I want to have the locks to my house changed, I can call somebody and have the key changed.

Lara: Nope. So, each wallet has its own unique key, so you can't change the key, but you could always transfer assets to a new wallet with a new key.

Mary: So, if I start, like, let's say that I decided my trusted person was my spouse and then find out my spouse is cheating on me. I decide to file for a divorce. I can't change the key to the wallet, but what I can do is create a new wallet and transfer the cryptocurrency to the new wallet.

Lara: That's exactly right.

Mary: Okay. And so, then what's your next thought on solutions?

Lara: So, the third solution is to just sprinkle the key among intended beneficiaries, but keep in mind when the time comes, they need to understand how to decipher it appropriately. So as an example, you can give your spouse digits, ABC, your son, D E F and your daughter GHI but you know, what if one of them loses their key or passes away or is incompetent, a better solution might be to give your spouse, ABC and D E F your son D and GHI and your daughter GHI and ABC. So that way two people are still required to decipher the entire code, but the loss of one will not be fatal to accessing the account and then the last option I just want to mention is called a dead man switch. So instead of including another person on a transaction, a computer actually acts as the third verifying party in this situation, a program periodically, believe it or not sends messages, asking if the cryptocurrency user is still alive. If there's no response after a specific number of tries or a certain period of time, then the program will activate a switch automatically and transfer the virtual coins to an intended beneficiary.

Mary: So, if you use this dead man switch, you need to be aware of how often you're going to get these messages. So, if you decide to take a long cruise through river wilds, where there's no access to the internet and you start getting these messages, and then you come back and you find out that all your crypto was transferred to the beneficiary. And you're like, what I was just out of pocket.

Lara: That's problem. But, you know, usually we're talking more like an 18-month period or something like that, and you have time built in to respond. So, it's usually like, not like two weeks when you're on the river cruise and then, you know, the crypto's done.

Mary: I was thinking that 18-month river cruise would be good, but so you have some time it's not gonna be such a short window that it's gonna get transferred and

Lara: That's right.

Mary: Are you in control of that time period when you purchase a program like that,

Lara: You set that, so you set the parameters of the dead man switch.

Mary: Okay. So, what else on that?

Lara: So I just wanted to mention that details regarding crypto accounts and keys, as important as it is to give that information to your intended beneficiaries, that information should not be in the estate planning, documents themselves, because for instance, if they're included in a will, they could be made public now in probate court and anyone can access them and similarly, if they're included in a trust agreement, they could be revealed to other trust beneficiaries who aren't even the intended recipients of those crypto assets and finally, I just wanted to say with respect to that, is that in addition to including specific language in revocable trust or will an individual's power of attorney should authorize their fiduciary agent to access the crypto accounts in the event of the holders in capacity.

Mary: So, what do you recommend that people discuss specifically with their trust in an estate attorney when planning for crypto assets.

Lara: Ultimately as part of proper estate planning, an individual should discuss ownership of the account by a revocable trust or will at death within the trust, or will the instrument should specify the disposition of cryptocurrency. So, should the account be transferred in kind to the beneficiaries, or should the assets be sold? Can the trustee or executor hold a concentrated position in cryptocurrency or will the account to default to diversification rules careful consideration should also be given to who will serve as executor or trustee. Currently many institutional trustees have policies against administering trust with cryptocurrency or require the immediate liquidation of the crypto accounts. So, an experienced individual trustee, as opposed to a corporate trustee, may be required for crypto accounts or all trust assets.

Mary: So, there will probably be a market evolve if this continues for you have some specialized trustees or custodians that might ultimately specialize as it will be the special trustee for this particular type of asset. Because I can understand a lot of your financial institutions are not going to want to have that responsibility as a trustee. Are there no unique considerations that should be taken into account when you make a gift of cryptocurrency?

Lara: Yes, so we talked about this briefly, the IRS treats cryptocurrency as property as opposed to currency. So, it's important that the basis of cryptocurrency be properly documented supporting documentation should be provided to the donee of the gift and also the fair market value of the cryptocurrency on the transfer date. The donor also needs to document fair market value for themselves. If a gift tax return is necessary.

Mary: Just a question that, because I ran into this during the tax season, we review a lot of different types of returns or see a lot of different returns and this is the first year we've seen a really high volume of the cryptocurrency, but I, I think there are no currently there currently are no requirements to issue 1099 or K1. If you have an investment account with, you know, Morgan Stanley or Goldman Sachs, you're going to get a 1099 showing your dividends, your interest, and your transactions. I don't think we have that yet with cryptocurrency in the tax.

Lara: Yes, and that's part of what I think we were saying earlier is there's got to be like evolution of all this stuff. You know, the, these are all things that the IRS has got to be looking at and will probably at some point issue rules around.

Mary: That's what I would expect. So, cryptocurrencies not formally titled what does the donor consider in terms of the gift?

Lara: So, it, in terms of fair market value, do you mean on the transfer?

Mary: Yes. How do we determine that?

Lara: So, it, it is very difficult to determine fair market value for cryptocurrency. Believe it or not. If the cryptocurrency listed on an exchange is valued according to market supply and demand, and then converted into us dollars at the exchange rate, then the cryptocurrency would seem easy to value, but the IRS requires calculation of fair market value quote, in a manner that is consistently applied. So, this differs from stock, for example, on the New York stock exchange, because the same cryptocurrency can have different values on different exchanges at the same exact time. So, valuation may require an appraisal in some situations and as you said, because cryptocurrency is not formally titled the donor should consider executing. What's called a gift memorandum contemporaneously with the gift for the records of both the donor and the donee, because these things are not titled in their names. So if possible, it's best to have the donee also execute the memo or at least a receipt for the donor's records and this memo should detail all of the relevant information, which would include a description of the gift, the type and amount of the cryptocurrency gifted the date of the transaction, the fair market value of the gift on the transfer date, the donor's basis, and a statement that the donor has actually transferred ownership in the case of a gift to a charity. Then the memo should include language stating that the gift meets charitable deduction requirements.

Mary: Lara, one of the thoughts that I had is you're talking about that is, do we have appraisers? And I'm just getting acknowledge. I have not had to value crypto yet for a 706 or a 709. So, are there appraisers specializing in that?

Lara: So, I thankfully have not to deal <laugh> deal with that either, but you know, I would assume there are appraisers. It doesn't seem terribly complicated because when you look at the values on different exchanges, they're typically just differing by a few dollars or a few hundred dollars depending on the type of crypto asset. So, I would assume that a lot of these appraisers of more traditional assets will start incorporating valuation of cryptocurrency into their practice as well.

Mary: Another area of specialty for the appraisers though, right? That's you got it. A part of the evolution we're discussing that we'll see and talk about on a future episode. Yes. So, what, what should be considered when gifting to charities using cryptocurrencies?

Lara: So, one suggestion I have is to donate highly appreciated cryptocurrency directly to a charity. The charity will receive full value of the cryptocurrency and the donor will receive a charitable income tax deduction for the full fair market value. The charity will not be subject to any capital gains tax on the appreciated value and the donor could donate instead of to a charity, for instance, to a donor advised fund, or what's called a DAF, which accepts cryptocurrency to, to get that same result.

Mary: So, the charitable gifting is an option and our charities, they're probably not keeping the cryptocurrency. If they receive a gift in cryptocurrency, are you seeing them then cash it?

Lara: The few that I've been involved in, they do then cash it out. I would think charities don't love at this point in time, given the volatility to hold onto crypto assets.

Mary: Which will be another interesting thing to keep an eye on in the future.

Lara: Yes.

Mary: So, Lara do you have any last thoughts today?

Lara: Yes. I would like to mention that crypto accounts and estate planning techniques, as we've talked about throughout will likely adapt and change very rapidly in the coming months and years. So a good first step is discussing options with a qualified estate planning attorney, a crypto investors should make sure that he or she discussed the strategies appropriate to his or her objectives and create or modify estate planning documents to properly address the transfer and administration of these assets and finally, I want to thank you again, Mary, for having me as always, I really enjoyed our conversation

Mary: I really enjoyed having you Laura, thanks so much for your contribution on this topic.