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What To Know About Estate Planning for Digital Assets

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INTRODUCTION TO BLOCKCHAIN AND DIGITAL ASSETS

As Digital Assets become more accepted by the investing public, whether as part of a diversified portfolio or as an alternative medium of exchange, attorneys, advisors, and valuation professionals must become equipped to advise owners of Digital Assets about how to value and dispose of these assets as part of their estate planning.

Once upon a time, only governments created and issued currencies (often referred to as “fiat currencies”). Now, developers create cryptocurrencies that are held in digital wallets. These cryptocurrencies, sometimes referred to as virtual currencies, alternative currencies, digital tokens, or “coins” (collectively, “Digital Assets”) are digital stores of value that allow for immediate transactions and borderless fund transfers.

Digital Assets use encryption techniques for governance and security and operate independent of any central bank. Digital Assets are built on top of blockchain technology, a distributive ledger that operates

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on a shared and synchronized digital database. On a blockchain, all transactions take place across a peer-to-peer network (P2P) of computers known as nodes, which are connected to the blockchain through the internet. The ledger is visible to anyone (all nodes) within the network, though differences in access exist between public and private blockchain systems. The difference relates to who is allowed to participate in the network, execute the *consensus* protocol, and maintain the shared ledger. In a public blockchain network, like the Bitcoin blockchain, the network is completely open and anyone can join and participate. In a private blockchain network, participants require an invitation in order to join and participate. Businesses that set up a private blockchain will generally construct a permissioned network.

The blockchain ledger permanently records, in “blocks,” the history of exchanges that take place between the peers in the network. All the completed and authenticated transaction blocks are connected and “chained” from the beginning of the chain to the most current block. Hence, the name “blockchain.”

There is a low risk of fraudulent transactions using blockchain because tampering with the ledger entries would have to occur in all of the many ledgers in the system at the same time. A very small change to the ledger would result in a change to the computing algorithm, raising a red flag of a fraudulent transaction to all computers on the P2P network. Digital signatures (signed with private keys) safeguard that transactions on the blockchain occur between legitimate participants on the P2P network and not from imposters.

ESTATE PLANNING CONSIDERATIONS FOR DIGITAL ASSETS

The traditional landscape of estate planning and estate administration must be revised and upgraded to adapt to the digital age. As noted above, numerous assets and information are no longer held by conventional methods and are instead held or accessed digi-

tally. Wealth managers, attorneys, and professional advisors must be educated on the existence of their clients' Digital Assets and the rules and guidelines for the management, taxation, and disposition of those assets in connection with estate planning and estate administration. A deeper awareness of how the acceleration of technological developments will further change this area is also important to implement methods to periodically revise strategies and procedures in this area.

Special planning considerations must be made in estate planning documents for clients whose assets include Digital Assets for several reasons:

- Unlike cash in a bank or tangible property such as furniture or jewelry, Digital Assets may not easily be located.
- A court-appointed fiduciary may not have the authority to access a client's Digital Assets to transfer them to the named beneficiary in a will or trust.
- Digital Assets present new valuation considerations.

Understanding the definition of Digital Assets is the first step in the planning process. There is no current standardized definition of Digital Assets. Indeed, the FinTech community, academics, estates and trust practitioners, and different governmental authorities all have varying — and potentially conflicting — definitions of Digital Assets. The definition of Digital Assets in the Uniform Law Commission's model legislation, the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA), is a good starting point for purposes of estate planning and administration and is becoming the most widely accepted definition of Digital Assets. RUFADAA legislates how an owner of Digital Assets can authorize someone to access the assets after his or her death. Surprisingly, under these rules merely appointing someone — even a spouse or child — as an executor of a will or trustee of a trust is insufficient to confer these access rights.

RUFADAA defines Digital Assets as “an electronic record in which an individual has a right or an interest.” This term does not include an underlying asset or liability unless the asset or liability is itself an electronic record. For example, although Digital Assets do not include devices, computers, or external hard drives, all of the data saved on computers and devices, as well as information and interests managed online, are an individual's Digital Assets.

Digital Assets include email communications, records, financial information, and pictures stored on devices, platforms, or clouds, as well as social media accounts, loyalty programs, electronic books, websites, trademarks, and other Digital Assets associated

with a monetary value. Cryptocurrencies, digital tokens, and records stored or rights accessible on blockchain platforms are also Digital Assets. However, not all Digital Assets are conveyable. Many are governed under Terms of Service Agreements (TOSAs), which are agreements between service providers and users of the service that limit the user's right to transfer the asset or account, such as the iCloud service.

The next step in the process is to understand the various laws currently in place governing this area. A version of RUFADAA or similar legislation has been passed in 46 states. RUFADAA was promulgated to provide clarity stemming from uncertainties existing under federal laws enacted in the 1980s, such as the Stored Communications Act and the Computer Fraud and Abuse Act. The Stored Communications Act, a subset of the Electronic Communications Privacy Act, protects privacy and restricts accessibility to contents of files stored by service providers and records held about subscribers. The Computer Fraud and Abuse Act penalizes people who access computers and data without the requisite authorization from the user. Variations of these federal laws have been adopted in each state. Neither of these federal and state laws address whether a fiduciary (agent under a power of attorney, executor/administrator, trustee, or guardian) has the legal ability to access the user's Digital Assets at the user's death or incapacity.

RUFADAA provides methods for authorizing fiduciary access to Digital Assets and also addresses the limited information that can be provided to a fiduciary when such methods were not utilized. RUFADAA requires a user to establish clear consent in order for a fiduciary to access a user's Digital Assets and sets forth a hierarchy of priority for such access. Rights are first granted to the person designated in an online tool, which is an electronic service provided by the service provider that allows the user, i.e., the owner of the Digital Asset, to provide directions for disclosure of Digital Assets to a third party, such as the user's executor or spouse, or anyone else the user wished to designate. Even with the use of an online tool, a service provider may still limit access to Digital Assets.

Next in priority, i.e., if no online tool exists or is not completed, RUFADAA grants access based on a specific designation in a will, trust, or power of attorney (testamentary document) consenting to such access. If a user failed to grant access to Digital Assets in both an online tool and testamentary document, access will be determined by the service provider's TOSA, if such an agreement exists. Interestingly, if the designation in the testamentary document — even a later-in-date testamentary document — conflicts with the online tool, the designation in the online tool prevails provided that the user had the ability to change the designation in the online tool until his or

her death. Thus, any time designations concerning Digital Assets are made in a testamentary document, it is critical to confirm that such designations have not been made — or will not be made — so as to be construed as contrary to the designation in an online tool.

In situations where neither an online tool nor testamentary document provides access, all hope for full access is not lost. Under RUFADAA, full access can still be granted to the person designated in a service provider's TOSA. However, this transfers the power to determine access from the owner of the Digital Assets to the service provider. Accordingly, wealth managers, estate planners, and other advisors should instruct clients to never rely on TOSAs because they may change, be silent on access to Digital Assets, or grant access to someone other than whom the client would select. The latter is especially true for unmarried clients likely to designate a close friend as their fiduciary.

Finally, when a user fails to authorize access in an online tool or testamentary document and the TOSA is silent on access, RUFADAA grants access to only a limited amount of information relating to a user's Digital Assets, which cannot include any information about the content of the Digital Assets. For purposes of obtaining access to a user's Digital Asset(s) after the user has died, the minimal information that a fiduciary receives under the default RUFADAA rules may be insufficient for the fiduciary to actually locate and transfer the user's Digital Assets. Cryptocurrencies require the use of a private key (which is an alpha numeric code) in order to access and transfer the Digital Asset(s), which key may not be known or easily uncovered without proper planning.

VALUATION OF DIGITAL ASSETS

Despite functioning as a medium of exchange, holding Digital Assets is not like holding cash or marketable securities. The key concern with Digital Assets is their volatility. As an example, Bitcoin, the largest and most established cryptocurrency (market cap: \$208 billion, as of July 12, 2019), is historically more volatile than oil, U.S. equities, and emerging currencies. The next two largest cryptocurrencies, Ethereum and XRP, are even more volatile and have market capitalizations of only 7% to 14% of Bitcoin.

Other issues (apart from high volatility) to consider in estimating the value of Digital Asset holdings include:

- **Potentially Limited Liquidity:** Digital Assets often trade on exchanges with varying degrees of liquidity and at times offer different price quotes for the same tokens.
- **Lack of Stable Prices:** According to Goldman Sachs, the top three cryptocurrencies have ex-

perienced price declines exceeding 15% between 30 and 45 times in the past 10 years (by contrast, the S&P 500 has experienced a 15% drop 22 times since 1945).

- **Cryptocurrencies Are Not Money:** Cryptocurrencies are not universally accepted as a medium of exchange due to discomfort with tokens or inability to process payments; in the United States, roughly 8% of adults hold cryptocurrencies (the corollary, of course, is that 92% do not).¹
- **Regulation:** Based upon the “Howey Test” (*SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)), some Digital Assets may be securities, not currencies, which would likely materially reduce their value (discounts associated with Initial Coin Offerings, or ICOs, ranged up to 50% in 2017 and 2018);² moreover, Central Bank regulation of cryptocurrencies could arise if such currencies grow to interfere with Monetary Policy targets.
- **Blockage Discount:** Material holdings of a Digital Asset may necessitate consideration of a “Blockage” discount, which is a discount from the quoted public or exchange price of an asset. The discount arises because the size of the block is sufficiently material relative to average trading volume that sale of the block en masse would depress the market price.
- **Possibility of Hacking and Theft:** In the past five years, over \$1 billion has been stolen from digital wallets.³
- **Token Survivorship Concerns:** It is far from clear whether multiple cryptocurrencies are necessary; just as Google has come to dominate search, Bitcoin could dominate the token space, rendering other cryptocurrencies' worth a mere fraction of their current values.⁴

To paraphrase *Casablanca*, Digital Assets are like any investment asset, only more so. As with any asset, it is critical to understand the nature of the investment, the size of the holdings, the market in which the asset trades, and the risks to which the asset is subject.

¹ How Many People Own Cryptocurrency, ICO Making (July 12, 2019).

² See www.icotracker.net.

³ See, e.g., \$32mm Stolen from Tokyo Cryptocurrency Exchange in Latest Hack, *The Guardian* (July 12, 2019).

⁴ Metcalf's Law posits that being connected to a network gets more valuable as the network grows, even as the cost of joining falls. This explains the “winner-take-all” nature of competition among many digital services.

CONCLUSION

Digital Assets are a new virtual and estate planning currency. Accordingly, to effectively represent the ever-growing population of Digital Assets owners, estate planners must familiarize themselves with the

universe of Digital Assets and understand the rules regulating their disposition and valuation. Indeed, ownership of Digital Assets has not only changed the way the world transacts business, it has — and will continue to — add a new dimension to estate planning.