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Estate Planning for Regulated Assets: Cryptocurrency, Digital and Other Unusual Assets

Fiduciary Responsibilities, Plan Considerations and Administration of Trusts Holding Regulated Assets

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ESTATE PLANNING FOR REGULATED ASSETS: CRYPTOCURRENCY, DIGITAL AND OTHER UNUSUAL ASSETS

AASTHA MADAAN

CHRISTOPHER SIEGLE

VICKI LEVY ESKIN

AGENDA

AASTHA MADAAN

1. Background on Blockchain and cryptocurrency

2. Estate planning issues particular to cryptocurrency and other digital assets

CHRISTOPHER P. SIEGLE

3. Methods of incorporating cryptocurrency into an estate plan

4. Regulatory challenges and fiduciary responsibilities in handling digital assets

VICKI LEVY ESKIN

5. Other unusual and regulated assets

6. Best practices to ensure effective administration of highly regulated assets

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BLOCKCHAIN

AND

CRYPTOCURRENCY

BLOCKCHAIN

- What is blockchain?
- A blockchain is a continuously growing list of records called "blocks" which are linked and secured. Each block contains (1) a timestamp (2) transaction data and (3) and a hash pointer.
- A blockchain "hash pointer" is a link to the previous block. Since each block contains information about the previous block, all blocks in a block chain are connected to each other and the chain of blocks cannot be broken.

USES OF BLOCKCHAIN

- Blockchain technology is used in many ways, including cryptocurrency, smart contracts, and financial services.
- Cryptocurrencies use blockchain technology to keep track of transactions.

CRYPTOCURRENCY

Cryptocurrency is a digital asset and like other digital assets, there are several times of cryptocurrency. Key elements of cryptocurrency:

1. Secured Financial Transactional

   HOW? Using Cryptography

2. Controlled creation of additional units

   HOW? Using blockchain

3. Verification the transfer of assets

   HOW? Using Wallets (and keys)

TYPES OF CRYPTOCURRENCY

There are reportedly over 4,000 types of cryptocurrency.

Bitcoin is the oldest cryptocurrency and many have emerged since. Bitcoin was released in 2008

There are several others, such as Bitcoin, Ethereum, Ripple, Litecoin, Monero, and several others.

Bitcoin: A Peer-to-Peer Electronic Cash System

Satoshi Nakamoto
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www.bitcoin.org

Abstract. A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution. Digital signatures provide part of the solution, but the main benefits are lost if a trusted third party is still required to prevent double-spending. We propose a solution to the double-spending problem using a peer-to-peer network. The network timestamps transactions by hashing them into an ongoing chain of hash-based proof-of-work, forming a record that cannot be changed without redoing the proof-of-work. The longest chain not only serves as proof of the sequence of events witnessed, but proof that it came from the largest pool of CPU power. As long as a majority of CPU power is controlled by nodes that are not cooperating to attack the network, they'll generate the longest chain and outpace attackers. The network itself requires minimal structure. Messages are broadcast on a best effort basis, and nodes can leave and rejoin the network at will, accepting the longest proof-of-work chain as proof of what happened while they were gone.

1. Introduction

Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process electronic payments. While the system works well enough for

https://perma.cc/ZUV2-LZHL

MYTHS SURROUNDING CRYPTOCURRENCY

- Only people that have something to hide own cryptocurrency.
- Its not "legitimate."
- It is similar to an actual currency (meaning there is a single repository or record).
- It is similar to shares in a company (meaning more can be issued by the issuing party or company in control).

HOW DOES OWNERSHIP WORK? SELLING? PURCHASING?

- Wallets
- Public Key
- Private Key

ESTATE PLANNING ISSUES RELATED TO CRYPTOCURRENCY

(AND OTHER BLOCKCHAIN-BASED DIGITAL ASSETS)

ESTATE PLANNING FOR REGULATED DIGITAL ASSETS

Regulated digital assets can include:

- Online Banking Accounts
- Online Payment Systems like Paypal, Stripe, Venmo
- Anything that holds DATA*, including but not limited to..
- Music Streaming Accounts, like Spotify, iTunes etc.
- Stock Trading Accounts.
- Data stored in your servers or cloud, such as Google Drive, Dropbox etc.

THE DIFFERENCES

REGULAR DIGITAL ASSETS

1. Have a single point of contact (the Company).

2. Are regulated by different government entities.

3. Someone other than the deceased usually has access (bank, brokerage company etc.).

CRYPTOCURRENCIES

1. Have no single point of contact or governing entity.

2. Are not regulated or monitored by a govt. entity.

3. Nobody other than the owner has access.

BONUS: Are global; origin is hard to determine; don't have a static place and jurisdiction is virtually indeterminable.

TRADITIONAL METHODS OF ESTATE PLANNING

- Designating a beneficiary
- Power of attorney on the user's account
- Joint ownership of bitcoin
- Funding through a revocable trust

POWER OF ATTORNEY

- Springing Power of Attorney to go into effect upon incapacity.
- Sweeping powers over digital assets.
- Actual use: fax or take the POA+Dr.'s statements to financial institution.

ISSUES: DESIGNATING A BENEFICIARY

- No mechanism to do so.
- Even if there was a mechanism, there is no central oversight.
- There is no legal title so no ability to truly have designation or oversight.

BITCOIN-SPECIFIC OPTIONS

OPTION # 1: Make a copy of the Bitcoin wallet available to designated persons.

Issue: happens immediately; not at a triggering event. Complete access.

BITCOIN-SPECIFIC OPTIONS

OPTION # 2: Multi-signature options.

More than two parties must sign the transaction, and upon the investor's death, the third party and the beneficiary would both need to sign to complete the transaction.

- Gives fiduciaries (personal representatives/executors, trustees, agents under power of attorney) access to digital assets held by third-party service providers, with proper documentation and specific identification of the property

BITCOIN-SPECIFIC OPTIONS

OPTION # 3: Make a Trust the beneficiary.

There could be tax consequences associated with this.

Benefits include that the investor/grantor can appoint a trustee for the limited purpose of executing a multisig wallet.

Due to Bitcoin not being regulated as currency, the IRS governs these transactions differently, which my co-panelists will focus on.

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Planning with digital assets: what are the advisor and fiduciary to do?

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Issues with wealth transfer planning with digital assets

Common principles of wealth transfer

Income tax basis

- Carryover/transfer basis for gifts (§1015)
- Step up (or step down) in basis when assets are received from a decedent (§1014)
- How is basis determined with virtual currency (Notice 2014-21, included)?
  - Virtual currency is property (Q&A, A-1)
  - Taxpayer's basis is fair market value in US dollars as of the date of acquisition (Q&A, A-4)

Transferability

- Actual transfer necessary for a completed gift (Treas. Reg. §25-2511-1)
- What about transferability of virtual currency?
  - Virtual currency sent to the trustee's online wallet?
  - Grantor transfers private key to physical device, and gives that to the trustee?

Issues with wealth transfer planning with digital assets

Common tools of estate tax planning

- GRAT
  - Volatility is good
  - Short term minimizes mortality risk
  - Low 7520 rate
- Gift trust
  - Non-resident alien gift to US person (no gift tax)
  - Can apply GST exemption to value of asset transferred to trust
  - When is the gift complete when the property is a digital asset?
- Sale to irrevocable grantor trust
  - Low applicable federal rate (AFR)
  - Can defer the principal payment, absorbing volatility

Fiduciary trends

With the increased use of long-term trusts as part of a comprehensive estate plan, as well as trusts consisting of more complex and diverse trust estates including digital assets , the role of a fiduciary is becoming even more demanding

- Individuals are more reluctant to serve as trustee
  - More appreciative of the risk
  - Many state's laws exculpate certain fiduciaries from liability for aspects for the administration of a trust that the governing instrument directs be administered by another fiduciary
- Family offices and private trust companies may not always be qualified to administer specialty assets
- Corporate trustees are becoming more widely used
  - Building highly skilled groups to address complexity of diverse portfolio
    - Private equity
    - Hedge funds
    - Structured notes
    - Specialty assets
      - Closely-held businesses
      - Real estate
      - Digital assets

Understanding fiduciary duties is critical to managing "specialty assets"

There are two broad categories of fiduciary duties: the duty of loyalty and the duty of care. As such, a fiduciary cannot place itself in a position where other interests conflict with its duties and must exercise a reasonable standard of care. *Elmhurst Nat'l Bank v. Glos, 99 Ill. App. 2d 74 (Ill. App. Ct. 2d Dist. 1968).* To fulfill these two fiduciary duties, a trustee must:

- Treat beneficiaries impartially and fairly
- Report information to beneficiaries
- Never act in its own self-interest and avoid conflicts of interest
- Take control and preserve trust property, while keeping it separate and identified
- Enforce all claims and defend all actions
- Prudently delegate responsibilities where appropriate
- Use its "special skills" in its fiduciary capacity
- Ensure that discretionary powers are exercised "reasonably"
- Choose appropriate investments relative to risk tolerance of grantor and beneficiaries
- Ensure trust is being administered in compliance with the law

Trustees must generally manage “specialty assets” in the context of the overall portfolio

Uniform Prudent Investor Act

- Promulgated in 1992, it broadened the universe of available trust investments and allowed trustees to adopt more flexible asset allocations. Changes included:
  - Permitting investment in specialty assets as a part of the portfolio
  - Permitting delegation of investment management authority to a professional advisor and to be relived of liability for ongoing monitoring process if reasonable
  - Relieving trustees of liability to follow prudent investment, or oversight or process
  - Encouraging diversification of investments (Modern Portfolio Theory)

Uniform Principal & Income Act

- Enables implementation of Modern Portfolio Theory and total return philosophy. The trustee has the power to adjust between principal and income to the extent it considers appropriate, being mindful of the interests of the current and remainder beneficiaries.
- Permits investing to maximize total return at an appropriate level of risk without having to allocate assets in a way designed to produce any particular current yield

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The requirements of Regulation 9 affect "specialty asset" management by national bank trustees . . .

National Bank – Code of Federal Regulations: Title 12, Part 9

- Before accepting a fiduciary account, a national bank must review the prospective account to determine whether it can properly administer the account. Upon acceptance, the bank shall conduct a prompt review of all assets of the account to evaluate whether they are appropriate for the account.

- At least once each year, a national bank must conduct a review of all assets of each fiduciary account for which the bank has investment discretion. This review is to contain an evaluation of whether the investments are appropriate, individually and collectively, for the account.

- A national bank exercising fiduciary powers must adopt and follow written policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law, including policies and procedures involving the investment of funds held as fiduciary.

OCC Bulletin 2008-10

- Provides guidance on the annual review requirement, emphasizing that the process should:
  - Ensure that account investment objectives are current
  - Provide for an annual holistic assessment of the portfolio
  - Ensure that the valuation is current and the valuation methodology is appropriate

. . and the expanding scope of state laws makes digital assets even more complex to administer

Uniform law– Revised Uniform Fiduciary Access to Digital Assets Act ("UFADAA")

- Gives fiduciaries (personal representatives/executors, trustees, agents under power of attorney) access to digital assets held by third-party service providers, with proper documentation and specific identification of the property
- Imposes penalties on professional advisors who do not discuss ongoing and successor access to digital assets

“Specialty asset” review

National banks must have policies and procedures in place involving the investment of funds held as a fiduciary, including non-financial assets. The following procedures are typically followed to maintain compliance with federal banking regulations:

- Pre-acceptance due diligence review
  - Initial due diligence and analysis of prospective client and asset mix
  - Assessment of risk and management responsibilities
    - Tax matters responsibility
    - Investment responsibility
    - Management decision responsibility
- Holding (duty to use special skills)
  - Annual review
    - Performance analysis
    - Valuation analysis
  - Informed fiduciary
    - Watch trends and make investment decisions, if possible
    - Evaluation of market/possible transactions

Difficulties in managing "specialty assets"

- Access to information is often limited
  - "Private" family matters
  - Family restricts trustee's ability to manage assets
  - "Heartstring" assets—return is not as critical as preserving legacy or family use of property
- Lack of independence
  - Family driving decision, although not actual decision maker
  - Trustee is "straw person" until it is too late and litigation results
- Lack of coordination among family and fiduciary
  - Communication of the plan
  - Market Value Estimate ("MVE") not fully disclosed or understood
    - MVE is <u>NOT</u>:
      - USPAP compliant
      - IRS Revenue Ruling 59-60 compliant
      - Fair market value as defined by the IRS
      - Appropriate for gift purposes or estate planning
      - To be used for potential transactions
- Lack of understanding of performance and value

Management through a closely-held structure

To address complexity, centralize ownership and management of assets, and/or implement a succession plan, it may be desirable to form a closely-held entity such as a limited liability company to hold digital assets. The formation of the entity can limit liability exposure, while giving the fiduciary the ability to hire others to manage the underlying assets.

Example

- Closely-held business group works with an appropriate internal business partner to manage the underlying assets of the closely-held entity and determine the appropriate course of action in transactions, while:
  - Providing proper corporate governance, if necessary to protect the investment
  - Periodically analyzing the entity's overall performance
  - Determining an annual market value estimate

Analyzing closely-held assets as part of the portfolio

- Concentration issues
- Cash flow
- Possibility of required capital calls
- Long-term goal of holding
  - Equity appreciation
  - Income distribution
  - Family employed in the business
  - Portfolio diversification
- Management's succession plan
- Ownership succession
- Transfer restrictions
  - Ability to sell asset
  - Potential buyers may be limited
- Market Value Estimate and performance analysis is key

The sale of "specialty assets"

Quite often, a fiduciary is presented with the opportunity to sell an interest in a specialty asset. To avoid a potential breach of fiduciary duty, a high degree of diligence must be performed before the sale of a specialty asset held in a fiduciary account.

- Analysis of the reason for the sale
  - Opportunistic
  - Liquidity needs
  - Portfolio restructuring
- Implementation of wealth transfer or estate plan
- Process
  - Understanding terms and objectives of the grantor/ trust instrument
  - High level of due diligence and approvals
  - Value on its face and structure of the deal
  - Ability to sell (consents, restrictions, market)
  - Working closely with professional advisors
  - Communication

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V. Other unusual and regulated Assets

- Communications: Internet, broadband, smartphone, tablet application – web-browsing, video & audio streaming, Social media
- Shopping: Mobile banking, travel, healthcare – monitoring, diagnosing, medical condition management
- Education

- Ride Hailing
- Sales
- Digital platforms are transforming innovative and independent work models
- Netflix – example of edge provider – huge traffic on wireless networks

Four National Providers of Cell Service:

- AT&T
- Sprint
- T-Mobile
- Verizon

Competition: price, promotions, network coverage and quality of service

What are the Risks?

- Abuse of IP or patient data
- Digital fraud within banking institution
- Hackers attacking energy networks
- Cyberterrorists (NATO involvement – but is it enough?)

Bureau of Labor Statistics

- Somewhat steadily falling prices
- Industry moving more from traditional macrocells toward small cells in transition to 5G fifth generation of wireless technology

CTIA Represents the US Wireless Industry

- TIA notes falling average revenue per unit (ARPU)
- Competition between the 4 major communication providers drives investment in the industry
- Which expands benefits to consumers and investors

5G and its impact

- 5G will use a higher frequency spectrum which travels shorter distances than low frequency, but can be made available by the FCC in wider bands, which will bring much greater speeds & lower latency
- This expands its usefulness for many application including sensitive ones such as telehealth and self driving automobiles, smart cities, drone commerce and much more

5G Expectation

- By 2023, 48% of National Subscribers will use 5g and retire LTE

What Laws Help/Hamper?

- December 2018: Token Taxonomy Act proposed by Warren Davidson and Darren Soto
- Seeks to exempt crypto currency and certain other digital assets from Federal Security laws
- Seeks to amend the Security Act of 1930 &
- Security Exchange Act of 1934 to exclude digital tokens from the definition of a security

- Seeks to direct the SEC to enact certain regulatory changes regarding digital units secured thru public key cryptography
- Seeks to adjust taxation of virtual currencies held in IRAs
- Seeks to create a tax exemption for exchanges of one virtual currency for another
- Seeks to create a de minimis exemption from taxation for gains realized from the sale or exchange of virtual currency for other than cash and for other purposes (?!)

Vl. Best practices to ensure effective administration of highly regulated assets

- Know the primary laws impacting the regulation of digital assets
- Read the most up to date information on law development, case law and trends
- Get your fingers wet and try out some of the technology in action, but wear gloves and practice safe computing

What ARE the laws impacting digital assets?

- RUFADAA is the ULC's effort to help with estate planning.
- This model code is in place in many states, but even where it is not in place, it may be utilized for some purposes

FCC

- Nineteenth Wireless Competition Report, WT Docket No 16-137, Sept 23, 2016, Chart III.A2, p.31
- Title II Common Carrier Regulation 2014-15
- Internet policy statement 2005 – No blocking of lawful content, apps or services, devices that do not harm the network; no prevention of competition among providers of networks, apps services and content; no discrimination; transparency

Title II of the Communication Act of 1930

- (BSPS) mobile broadband net access providers
- (NPR) notice of proposed regulation
- 2009: addressed matter of preserving open internet and broadband; industry practices
- GN Docket No. 09-991 & WC Docket No. 07-52 October 22, 2009 PP16
- Noted significant differences between fixed and mobile broad band

Verizon v FCC DC 2010

- Outlines reliance upon section 706 of the Telecommunication Act of 1996
- NEXT: June 3, 2015
- FCC imposes $100M fine against ATT for allegedly violating open-net transparency rule
- (throttled traffic for customers of unlimited plans to manage congestion)

Before the Verizon and AT&T cases

- These practices had been pretty much non regulated since 2010, thus now, there is a high level of risk for BSPS for providing unlimited plans

Proof of Concept

- Blockchain technology brings distributed ledger systems, organizations, partners to collaborate on payment flow, promotes platform communication
- Cryptocurrency – uses encryption to regulate limits and verity transfer outside a bank
- Blockchain vs Public Ledger
- Cryptocurrency – supply limit vs
- Digital assets – Supply infinity

DAML

- Digital Assets Modeling Language – seeks to initialize language
- Seeks to enable virtual immediate flow of payment throughout system
- Example: Patient to Physician Payment

Cryptocommodity

- Compare this to wood made into a wooden desk
- The language of the Ether is Etherian
- But Blockchain technology can define both language and value – sometimes
- Security Token Offerings are similar to Initial Coin Offerings
- There are Hybrid Tokens and Real World Asset Tokens

So what do we do?

- At a minimum:
- Have accurate user name and password
- Have encryption key
- If you don’t understand what your client has, either learn more about it or obtain assistance from someone who does understand – but this has its own perils
- Understand the differences with a virtual wallet
- Recognize that cryptocurrency and digital assets are NOT the same thing!

Recommended Sources of Information

- www.lexocology.com
- CTIA
- FCC NPRs (notice of proposed regulation)
- Congress
- Uniform Law Commission
- Investment Planners

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