

5 Updates to your Estate Plan for CRYPTOCURRENCY and NFTs



Gary L. Winter, Esq., California

Shannon P. McNulty, Esq., LL.M., Taxation, New York

LAWVEX



Gary L. Winter

Gary Winter is the Founder and Managing Attorney at Lawvex, LLP, a California estate and trusts law firm with offices in Clovis, Madera and Santa Barbara.

Following Lawvex' unique blend of digital lawyering and high-touch client service, Gary has helped clients with thousands of estate, trust, business succession, and charitable giving plans and administration over his 16 years of practice.

Prior to law school, Gary was a commercial airline pilot for a major U.S. airline. Gary graduated with High Honors in 2006. After law school, Gary served as judicial extern to the Honorable Justice Timothy S. Buckley, 5th District Court of Appeal, and practiced law at Central California's largest law firms - McCormick Barstow in their Business and Personal Planning group. Gary launched his own solo practice in 2009 and after successfully growing to capacity, rebranded as Lawvex in 2014 and started adding partners and offices. Lawvex has been a fully cloud-based, decentralized law firm with partially remote and fully remote workers since 2014.

Gary is a sought after podcast guest and speaker on subjects such as legal technology, digital lawyering, law practice management, and charitable giving. Gary is an adjunct faculty member and Professor of Legal Technology at San Joaquin College of Law. Learn more at <https://www.lawvex.com>



Shannon P. McNulty

Shannon McNulty is a highly experienced Trusts & Estates and Tax attorney who counsels individuals and families on all aspects of estate planning.

She provides clients with road maps for taking care of their families in the event of their death. Her advice is sophisticated and reflects her deep knowledge of the laws governing estates, taxation and child guardianship issues. Shannon approaches each client with sensitivity and compassion, understanding that many of the decisions that they will have to make can be difficult.

Shannon is regularly asked to serve as a consultant to other law firms on complex tax and international tax and estate planning issues. Before launching her own firm, Shannon practiced law at two of the country's largest law firms- Curtis, Mallet-Prevost, Colt & Mosle and Skadden, Arps, Slate, Meagher & Flom, where she was involved in sophisticated domestic and international tax and estate planning. She served as a judicial clerk for a U.S. District Court Judge of the Southern District of New York.

She has appeared on MSNBC as a legal commentator about celebrity estates and has been published in Forbes.com. Shannon is also the founder Savvy-Parents.com, an online resource dedicated to helping parents make smart legal and financial decisions for their family. Her podcast addresses the estate and tax issues that are important to young as well as international families.

Shannon McNulty received her LL.M. in Taxation from New York University School of Law and graduated cum laude from Georgetown University Law Center, where she served as an Articles Editor for the Georgetown Law Journal. She has also earned the CERTIFIED FINANCIAL PLANNER™ designation from the Certified Financial Planner Board of Standards. Ms. McNulty is a member of the Tax Law and Trusts and Estates Sections of the New York State Bar Association. Learn more at <https://www.thevillagelawfirm.com>

Update 1: Access and Authority

Your agents and trustees need access to your Digital Assets.

Make sure you update your estate plan to include authorization for your agents and trustees to access the various types of Digital Assets that you own. Otherwise, when you become incapacitated or pass away, they may not have the ability to access your assets without violating privacy laws.

Consider having your estate attorney include language in your Power of Attorney and your Trust that authorizes the agents and trustees to buy, sell and hold, Digital Assets. Make sure “Digital Assets” is defined broadly enough to encompass whatever type of cryptocurrency or NFT that you hold or may hold in the future.

Most trustees are bound by some version of the “prudent investor rule”. This means that trustees can be personally liable if they invest trust assets in unreasonably speculative or unproven assets. If you intend to have your trustee hold digital assets, you may consider amending your Trust and opting out of the prudent investor rule, so that your trustee is not compelled to sell your Digital Assets simply out of fear of personal liability.

“If you don’t believe it or don’t get it, I don’t have the time to try to convince you, sorry.”

– Satoshi Nakamoto, anonymous pseudonym used by the creator of bitcoin

Update 2: Transfer Documents

Prepare a specific Assignment to Trust for Digital Assets.

Centralized cryptocurrency exchanges such as Coinbase, Kraken, Gemini are owned individually. They currently do not support or open accounts for trustees. Nor do they allow transfer on death/pay on death (“TOD/POD”) beneficiary designations. So, traditional methods of funding cryptocurrency to your trust by holding title as trustee or naming your trust as TOD beneficiary currently may not be available.

Digital Assets are currently characterized as personal property. Like art, there may not be any form of pink slip or deed to evidence title. One solution is to have your estate attorney prepare specific Assignment documents that identifies the Digital Assets and assigns/transfers ownership of the Digital Assets as personal property to your Trust.

Along with the Assignment, have your estate attorney update the asset list for your Trust, sometimes referred to as “Schedule A” and include specific identifying references to show that it was your specific intention for the Digital Assets to be Trust assets and subject to the terms and conditions of the Trust and under the Trustee’s fiduciary control should you become incapacitated or pass away.

Community property states, such as California, often include “Schedule A” community property, “Schedule B” husband’s separate property, and “Schedule C” wife’s separate property. Make sure to include the Digital Assets on the appropriate schedule.

“Stay away from it. It’s a mirage, basically. In terms of cryptocurrencies, generally, I can say almost with certainty that they will come to a bad ending.” – Warren Buffett

Your agents and trustees need access to your Digital Assets.

Make sure you update your estate plan to include authorization for your agents and trustees to access the various types of Digital Assets that you own. Otherwise, when you become incapacitated or pass away, they may not have the ability to access your assets without violating privacy laws.

Consider having your estate attorney include language in your Power of Attorney and your Trust that authorizes the agents and trustees to buy, sell and hold, Digital Assets. Make sure “Digital Assets” is defined broadly enough to encompass whatever type of cryptocurrency or NFT that you hold or may hold in the future.

Most trustees are bound by some version of the “prudent investor rule”. This means that trustees can be personally liable if they invest trust assets in unreasonably speculative or unproven assets. If you intend to have your trustee hold digital assets, you may consider amending your Trust and opting out of the prudent investor rule, so that your trustee is not compelled to sell your Digital Assets simply out of fear of personal liability.

“If you don’t believe it or don’t get it, I don’t have the time to try to convince you, sorry.”

– Satoshi Nakamoto, anonymous pseudonym used by the creator of bitcoin

Update 3: Physical Custody

Have the trustee hold the wallet key.

If you buy Digital Assets, and you want to store it yourself (as opposed to having an institutional fiduciary), then you must choose between holding your Digital Assets in a “hot” wallet, or a “cold” wallet.

Each wallet has its own long set of numbers and a certificate (the “private key”). The private key is an impossible to fake file, that allows you to connect to the blockchain.

Cold Wallet

A cold wallet is analogous to a briefcase with money inside. To send or receive assets you must hold and manage three important things: 1. The Address/Hash/Wallet ID, generated by the blockchain; 2. The Certificate – a digital file; and 3. The File Based Password. These are the three necessary parts to manage any transaction. The risk is that if any of these things are mismanaged, you can actually lose the assets.

Hot Wallet

As an alternative to the sophistication and risk associated with cold wallets, hot wallets are controlled or managed by a third party exchange such as Coinbase, MetaMask, and Edge Wallet. They were all approved by the SEC to function in this capacity. They keep the password totally private and validate you through your login. There is a recovery phrase in the event you lose your password. You do NOT want to lose the recovery phrase. With a hot wallet, whoever has the recovery phrase controls it and can access it if you become incapacitated or pass away.

So, one option is to have your trustee have access to the recovery phrase. This could be held in a bank safety deposit box, or, if you don’t want to trust anyone with the entire recovery phrase, consider “sharding” it or splitting it up. See Update 4, below.

“I do think Bitcoin . . . has the potential to do something like change the world.” – Peter Thiel, co-founder of PayPal

Update 4: Shard the Wallet Key

Have your estate attorney and trustee hold the wallet key 50/50.

The recovery phrase is typically a 12-word phrase with random words, not arranged in any particular order.

For example, a recovery phrase could be: “horse rug sweater truck monitor block picture bonus window reform wheel grape”.

Most everyone uses hot wallets for Digital Assets. With a hot wallet, whoever has the recovery phrase controls it and can access it. The concept is this should be somewhat streamlined if you become incapacitated or pass away. So, one option is to have your trustee have access to the recovery phrase. This could be held in a bank safety deposit box. But, the risk is that your trustee or someone close to them could actually access it prematurely and steal it.

So, if you don't want to trust anyone with the entire recovery phrase, consider “sharding” it or splitting it up. Sharding the recovery phrase is a matter of dividing it into two parts.

For example, provide your trustee with this half of the recovery phrase: “horse rug sweater truck monitor block” and your estate attorney with this half: “picture bonus window reform wheel grape”. This way, neither can access the Digital Assets without the other. Sort of like two keys for nuclear weapons...

“The Federal Reserve simply does not have authority to supervise or regulate Bitcoin in any way.” – Janet Yellen, former chair of the U.S. Federal Reserve

Update 5: Consider Taxes

Taxation of Digital Assets.

The rules governing the taxation of cryptocurrency are fairly straightforward, yet they can be counterintuitive if you think of cryptocurrency the way you think of money. When you use US dollars to make a purchase, you don't have to track the value of the dollars when you use them to pay for goods or when you receive dollars for performing services. This isn't the case when these payments are made in cryptocurrency.

Sale or Exchange of Cryptocurrency

Rather than treating cryptocurrency like cash, the IRS treats it much like stock in a corporation. If a share of stock increases in value between the time you purchase the stock and the time you sell it, the difference between the purchase price and the sale price represents capital gain, and you must report this amount on your tax return. The applicable tax rate will depend both on the length of time you hold the stock and your individual tax bracket for the year in which the stock is sold. If you hold the stock for more than one year, long term capital gains rates (0%-20%) will apply. If you hold the stock for less than one year, short term capital gains rates apply (0%-39%). You may also owe a net investment income tax of 3.8% if your income for the year exceeds a certain threshold. If, instead of selling stock at a gain, you sell it for less than you originally paid for it, you can report the loss on your income taxes and use it to offset other taxable income.

The same capital gain and loss rules that apply to the sale of stock also apply to the sale of cryptocurrency. For example, if you purchased one bitcoin in 2015 for \$300 and you exchanged it for cash in 2021 for \$50,000, you would have a long term capital gain of \$49,700, which would need to be reported on your 2021 tax return.

Where cryptocurrency can get confusing is when you use it to make a purchase – that is, you use it like money. In this case, the transaction is treated as if you sold the cryptocurrency for cash – triggering a capital gain or loss – and then used the cash to make the purchase. To illustrate, suppose that, in the example above, instead of trading your bitcoin for dollars, you used it to buy a Tesla. It might not feel like you're making money in this transaction, but the IRS will treat it as if you sold your bitcoin for cash and then used the cash to purchase the Tesla. The same would be true if you

exchanged the bitcoin for \$50,000 worth of Ethereum; this transaction would similarly trigger \$49,700 of capital gain.

If you then traded the Ethereum for an NFT, the transaction would again trigger tax if the Ethereum used to purchase the NFT had increased in value since you purchased it with bitcoin. If the Ethereum had declined in value, you would recognize a capital loss.

Cryptocurrency as Compensation

The rules are somewhat different when you receive cryptocurrency as compensation, whether for your work in a startup or as payment for mining the crypto. In this case, it is treated as Ordinary Income – not capital gain. This means that you would owe income tax on the crypto in the same way that you would owe tax when you are paid a salary or you are paid for work as an independent contractor. The Ordinary Income tax rates are generally higher than capital gains tax rates and range from 0% to 39.6%.

The company or individual who pays you in cryptocurrency would be treated as if they sold the crypto for dollars (recognizing capital gain) and then paid you in cash.

Income Taxation of NFTs

The income tax rules for NFTs are similar to the rules for cryptocurrency, with one caveat. NFTs held for more than one year may be taxed as collectibles, such as art, stamps, and antiques. The sale of collectibles are subject to a higher capital gains tax of 28%.

The IRS has not yet ruled on whether NFTs are collectibles, but it wouldn't be surprising if the agency took the position that certain NFTs, especially those representing artwork, were subject to the higher tax rate that applies to collectibles. This would mean that the taxation of an NFT would require looking through the NFT to the underlying asset that the NFT represents.

While we wait on guidance from the IRS, it's best to proceed with caution in this area.

“Bitcoin is a technological tour de force.”

– Bill Gates

If you are investing in cryptocurrency and you have a living trust, but your estate lawyer is not up to speed on the nuances of crypto and you are confused and worried about how to make sure your trustee has access to your cryptocurrency without unnecessary risk, then call now for your Digital Asset Estate Update Strategy Session.

If you have invested in cryptocurrency and you have significant unrealized capital gains, but your CPA just prepares tax returns and doesn't really do tax strategy, and you are feeling in the dark about options to mitigate taxes, then call now for your Digital Asset Estate Update Strategy Session.

If you are a philanthropist or just a successful cryptocurrency investor and you want to do your part to change the world, and reap some tax benefits at the same time, but it seems like nobody you know has any real world experience with charitable giving of cryptocurrency, then call now for your Digital Asset Estate Update Strategy Session.

Digital Asset Estate Update Strategy Session

Get your questions answered about your estate plan and cryptocurrency, what you need to update, charitable giving strategies and tax implications.

Call now:

California - Lawvex, LLP (888)308-7003 <https://www.lawvex.com>

New York - The Village Law Firm (212)431-7526

<https://www.thevillagelawfirm.com>