

# Estate Planning Strategies for Cryptocurrency

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While digital assets, or more precisely, cryptocurrency, have made certain transactions simpler, they have complicated the estate planning process. Clients who have acquired such assets must incorporate them into their estate planning documents or risk losing them forever.

Digital assets, or more precisely, cryptocurrency, are growing exponentially in terms of value and popularity. Although cryptocurrency and digital assets may have made certain transactions simpler, they have complicated the estate planning process. Clients who have acquired such assets must incorporate them into their estate planning documents or risk losing them forever. The traditional notion of distributing all assets via a residuary clause of a Last Will and Testament and then having an executor search for digital assets does not work in the new world of cryptocurrency.

## What Is Cryptocurrency?

All cryptocurrencies are fundamentally the same. They are merely digital currency, which exist online and not in a material or tangible form. They are really just evidence of entry in a public ledger maintained through the use of blockchain technology. There are no physical coins or notes, nor are the funds controlled by a central government. The currency is encrypted and decentralized and, as a result, it is extremely difficult to counterfeit. In its simplest form, when an individual purchases cryptocurrency, the purchase is associated with a public and private key. The public key is visible to the entire network of decentralized computers across the world and is a specifically recorded transaction with a unique identification that cannot be changed. A private key is the digital equivalent of a password and proves ownership of the cryptocurrency, which is stored in a digital wallet and is the

only method of accessing the digital currency.

Unlike a traditional bank account, an owner (or a fiduciary such as an executor or trustee) cannot contact any central institution and request access to the funds if the private key is lost or stolen. Anyone who obtains a private key would have access to the owner's cryptocurrency so the key must be safeguarded and protected. Think of it as a safe with only one non-replaceable key. While third-party companies, such as Coinbase, have now established a "vault," that is, in essence, a safety deposit box for a user's private keys, those owners who continue to retain their private key must proceed with caution and plan accordingly. As discussed in greater detail, below, since cryptocurrency is really just a series of unique computer code, it cannot be stored in the same fashion as fiat (or traditional) currency. If a decedent fails to plan properly, his or her digital assets may be lost forever.

## Taxation

The Internal Revenue Service has taken the position under IRS Notice 2014-21 that digital assets must be treated as property rather than currency for tax purposes. A sale or exchange can lead to capital gains or losses that must be reported on a tax return. Therefore, practitioners must consider the tax treatment of cryptocurrency when contemplating a gift or administering an estate upon death. Since cryptocurrency has value, it must be reported as an asset of any trust or estate and tax basis must be tracked. Consequently, cryptocurrency holders must maintain detailed records, including the date of acquisition and the fair market value upon acquisition. Consideration must also be made to the step-up in basis to fair market value with digital assets that pass through an estate.

## Estate Planning Options

Due to its anonymity and risk, traditional estate planning documents, including a Last Will and Testament and Trust Agreement are not well-suited to effect a transfer of cryptocurrency. Not only must a practitioner examine where digital assets exist online and how the cryptocurrency will be accessed/transferred to the beneficiaries, but they must also ensure that there are limited delays in carrying out the administration. Specific language must also be included in the client's estate planning documents which permit fiduciaries to access, retain, and manage the cryptocurrency.

As part of the planning process, it is critical that the fiduciary be provided with information pertaining to the existence of cryptocurrency and the manner in which to access it for transfer. To effectuate the actual transfer, a fiduciary must identify the beneficiary of the asset, and quite possibly, where the asset is located. If an owner invests in cryptocurrency but fails to discuss the investment with their family, or fails to include the information in their estate planning documents, the account will likely remain lost upon death. Likewise, if a decedent fails to leave their private key, or leaves their private key without an explanation of how to use it, the cryptocurrency will likely stay lost. In order to prevent these situations from happening, it is important to develop a plan for passing details of ownership. Practitioners must carefully consider a client's estate planning needs today to ensure that they are carried out after death. As part of the planning process, the practitioner should also ensure that a Power of Attorney is updated and permits an agent to access digital assets and cryptocurrency in the event of incapacity.

*(1) Sharing Keys.* While it is generally not recommended that a client ever share their private key due to security concerns, the simplest form of planning is for the client to provide their fiduciary or a trusted friend/family member with a roadmap to their information. It is imperative for the client to provide instructions and access to their digital persona, including passwords, locations and paths to all assets. However, whether the client considers writing down the private key and storing it in a secure but accessible location (such as a bank deposit box), or handing the information to the third party, the client must be apprised of the potential for asset theft. Each client must balance their lifetime needs against the risk that the currency could be lost or stolen. As a result, many clients prefer to hold and dispose of their cryptocurrency via their traditional estate planning documents.

*(2) Last Will and Testament.* Following the death of an owner, an executor can typically acquire cryptocurrency that is owned on an exchange, such as Coinbase or Kraken, through the administration process, including providing a death certificate, Last Will and Testament, Letters Testamentary and identification. However, a client who owns cryptocurrency that is not stored on an exchange (whether on a computer, flash drive or other mechanism) must take care and caution. A testator must plan accordingly and provide a roadmap for their executor and beneficiaries, since there is no formal record of the cryptocurrency.

If a testator does not share their key during their life, it is imperative that the client expressly refer to their cryptocurrency in their Will. This will ensure that the executor is aware of the asset and that the intended beneficiaries receive them. While the testator should never provide their private key in the body of their document since the Will is a public document, the testator should: (i) list their cryptocurrency in their Will; (ii) include information about retrieving such assets from digital wallets; and (iii) most importantly, create a separate memorandum with information pertaining to the digital wallet, passwords and private keys. Since a memorandum is a separate document, it can be updated without the legal formalities of changing a Will. The memorandum should then be stored in a safe deposit box, secure location or with a trusted individual, and the owner should explain how the executor and beneficiaries can ultimately retrieve the cryptocurrency. While it may seem counterintuitive to provide such valuable information in a document, if the cryptocurrency is omitted, there is a strong likelihood that it will never be found.

*(3) Trust Agreements.* Often, the primary reasons to fund a trust are for estate planning, asset protection, incapacity planning, privacy and avoiding probate. Ordinarily, it is very easy to transfer assets to a trust; however, cryptocurrency provides specific challenges and obstacles to such transfers. Nevertheless, although there is no legal impediment to funding a trust with cryptocurrency, many trustees and custodians may choose not to accept such property for a variety of reasons, including liability concerns.

One of the practical considerations is also funding the trust. Currently, most exchanges do not support cryptocurrency that is owned in trust. However, a grantor could transfer their private key to a secure physical device and then assign the device to the trustee. The transfer must be documented, and the grantor cannot retain any control over the transferred property. A memorandum should be simultaneously executed which includes the details of the gift, including the date of the transfer, the basis in the gift and the fair market value of the gift at the time of the transfer. If necessary, a gift tax return should be filed.

The trust agreement should also be drafted in order to provide specific reference to the cryptocurrency. Not only must a grantor provide details about the cryptocurrency, but the trustee must be provided with sufficient powers under the trust agreement that will enable him or her to retain and manage the cryptocurrency. Additionally, the trustee should be released and indemnified from any duty to diversify

investments.

## Fiduciaries

Some owners may have significant holdings that are beyond the scope of a typical fiduciary's knowledge. When planning an estate that includes cryptocurrency, practitioners should advise their clients to appoint a fiduciary who has the sophistication required to deal with cryptocurrency. When drafting the documents, language should be included that would not only enable the fiduciary to convert the cryptocurrency to cash, but also permit fiduciaries to access digital assets, including computers, cell phones and other devices that may contain information about the cryptocurrency. It is also important to provide specific powers to fiduciaries during life and after death, because even if the client shares the key during their life, the fiduciary must have permission to use the information after death.

Finally, practitioners must be cognizant of both federal and state laws that could potentially prohibit the transfer of such assets. For example, under the Uniform Fiduciary Access to Digital Assets Act (UFADAA), a fiduciary is permitted to manage and control digital assets, which includes electronic records and account information for exchanges, but the UFADAA does not authorize a fiduciary to access a private key. As such, fiduciaries must be provided with expanded powers under the terms of the documents if they will access a private key.

## Proper Planning Is Key

Since cryptocurrency is an intangible asset with no paper trail, special consideration must be made in order to ensure that the assets are not lost following the owner's death and can ultimately be distributed to intended beneficiaries. If an owner dies without passing on their private key, or if a key is discarded after death, heirs may ultimately discover the owner's key, but soon realize that they will never gain access to the cryptocurrency.

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