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CRYPTOCURRENCY 101 FOR ESTATE PLANNERS

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On December 9, 2018, Gerry Cotton, the CEO of QuadrigaCX, a major cryptocurrency exchange, died unexpectedly at the age of 30. Cotton's death irrevocably locked 100,000 cryptocurrency holders from their accounts (worth nearly \$200 million) because Cotton was the only person known to have the cryptographic keys to the master account. The code, it is believed, was in his memory; and when Cotton died, so did access to the accounts. Although most cryptocurrency owners are not facing the pressures of owning the master account of a major exchange, without proper estate planning, cryptocurrency may not pass to any beneficiaries because of the difficulty in accessing and identifying the assets. Around 34 million United States adults own cryptocurrency.¹ As a result, estate planning attorneys need to be aware of their clients' cryptocurrency ownership and how to plan for cryptocurrency assets to properly pass to beneficiaries without becoming lost or inaccessible.

What is Cryptocurrency?

Cryptocurrency is a digital currency that is used primarily for online payments, investment, or a store of value like gold or silver. It does not exist in a physical form, and users perform all transactions with a computer. The online payment platform for a cryptocurrency is what's known as "the blockchain." The blockchain is a ledger that records cryptocurrency transactions, keeps track of the cryptocurrency in circulation, and is not controlled or overseen by a centralized institution, like a bank. Because of the lack of control or oversight by a centralized entity, blockchains are "decentralized."

Several aspects of cryptocurrency are attractive to investors. The main attractive aspect is complete ownership of assets. With traditional currency held in a bank account, the bank has a level of control over assets. The bank can reject transactions, freeze accounts, sell account holder information, and make transactions with foreign banks tedious and expensive. With cryptocurrency, there is no central authority managing transactions and ownership, meaning that a central authority cannot reject transactions, freeze accounts, or sell information, and international transactions operate in exactly the same way as domestic transactions. Other attractive aspects of cryptocurrency are that blockchains are highly encrypted and nearly impossible to alter, making transactions less susceptible to cyber-attacks, and that, much like stocks, the value of cryptocurrency fluctuates based on the market, making for potentially exponential rates of return.

To illustrate concepts above, we will use Bitcoin as an example (the Bitcoin network uses a capital "B," and the cryptocurrency bitcoin uses a lowercase "b"). Bitcoin is the world's first

¹ <https://www.insiderintelligence.com/insights/us-adults-cryptocurrency-ownership-stats/#:~:text=Cryptocurrency%20payment%20users%20and%20transaction%20value%20stats&text=This%20year%2C%203.6%20million%20US,up%2068.6%25%20over%20last%20year>. Proper citations needed throughout article.

decentralized cryptocurrency. It was introduced in 2009 by a programmer or group of programmers going by the name “Satoshi Nakamoto.” Bitcoin is known to be highly volatile, despite it being the highest performing asset of any class (including stocks, commodities, and bonds) in the last decade as it has grown 9,000,000% between 2010 and 2020.² Each individual bitcoin is made up of 100 million smaller units, called “satoshis,” meaning that anyone can own 0.00000001% of a bitcoin for as little as one U.S. dollar.³

When a person purchases bitcoin with traditional money, that person will have to make an account and register their bank account with a cryptocurrency exchange that sells bitcoin. A cryptocurrency exchange is simply a platform that allows the purchase of cryptocurrency with traditional currency. Once purchased on the exchange, the bitcoin is stored in the person’s exchange account on the exchange platform until the purchaser creates a more secure cryptocurrency wallet in which to store the bitcoin. A cryptocurrency wallet is a digital storage device for cryptocurrency.

There are several ways to make wallets, one of which is called “cold storage.” Cold storage means that the user downloads software onto an SSD drive (a type of computer storage device that works in tandem with a computer’s hard drive) that creates a file containing the wallet on the person’s personal computer. The user may then transfer the wallet file onto a flash drive and insert the flash drive into their computer when making a transaction. This method is called “cold” storage because the wallet, being stored on a flash drive, is completely offline, which makes it more secure against hackers. Another method of creating a wallet is creating an online wallet with a cryptocurrency wallet service such as Blockchain.com, Coinbase, Electrum, or Exodus. The user will create a wallet account with the online service, and the online service will store the user’s cryptocurrency. Online wallets are generally more convenient and user friendly than cold storage methods, but they tend to be more susceptible to cyberattacks because the account and wallet information is stored online. The defining characteristics of a wallet are: (1) an address, which is a string of letters and numbers identifying the specific wallet (much like the IP address of a computer), (2) a password created by the wallet owner to access the wallet, and (3) a private key which is a large, randomly-generated number that must be entered in order to transfer cryptocurrency.

Once a wallet has been created, the user will transfer the bitcoin from the exchange account to their wallet by entering the wallet’s address. Now the user can make transactions with the bitcoin stored in the user’s wallet. To do this, the user will open the wallet, whether by entering the password to the file on the user’s computer or logging into user’s online wallet, select the option to send cryptocurrency, enter the address of the wallet that will receive the bitcoin (the recipient of the bitcoin will give this information to the user), enter the user’s wallet’s private key to authorize the transfer of the user’s cryptocurrency, and press send.

Once the bitcoin is sent, the transaction is broadcast to a diversified computer network that validates the transaction and records it on the blockchain. The blockchain, which is an

² <https://www.coindesk.com/price/bitcoin/>.

³ *Id.*

anonymous public ledger, then reflects the transaction, identifying the wallet addresses involved and the amount of the transaction. Another way to think about a cryptocurrency transaction is like an email exchange. The sender of the email enters the recipient's address, includes a message, and sends the email. The email is then broadcasted across the email's server, and the recipient receives the email.

The Need for Estate Planning

Cryptocurrency is a newer and unique asset class. This means that it will be important to update key estate planning documents to include cryptocurrency specific provisions and allow fiduciaries to identify the cryptocurrency. Further, it is not enough to simply identify the cryptocurrency; wallets and exchange accounts must be identified so that fiduciaries know where to look for the cryptocurrency. Additionally, in order to access the cryptocurrency from the wallets, the account information, passwords, and private keys must be provided for. Because of all of the moving parts associated with planning with cryptocurrency, estate planning attorneys must be able to keep up when a client walks in with cryptocurrency in their investment portfolio.

Estate Planning Documents and Fiduciary Access

There is no paper trail when it comes to cryptocurrency ownership. There are just records of public transactions on the blockchain, and the only identifying characteristics of the transactions are wallet addresses and amounts, essentially making the transactions anonymous. Therefore, if a client wants cryptocurrency to pass or be managed for them, the cryptocurrency will need to be identified in estate planning documents. Additionally, because there are layers to accessing cryptocurrency, such as account information, passwords, and private keys, all of those layers will need to be addressed in an estate plan. Estate planning attorneys should first create a section on cryptocurrency ownership on their client intake forms to get an idea of the needs of their client. If the client does own cryptocurrency, the estate planning attorney should (1) list the cryptocurrency in the will and/or testamentary trust, (2) include the types and locations of cryptocurrency wallet(s) in the will and/or testamentary trust, and (3) create a memorandum to the will and/or testamentary trust containing account information, passwords, and a step-by-step guide on how to access the cryptocurrency.⁴

If cryptocurrency is not specifically included in the will, it will fall into the residue of the estate, and it is possible that nobody will know that it exists because there is nothing documenting its existence. Unlisted cryptocurrency will very likely become useless. Therefore, cryptocurrency must be specifically listed in the will and/or testamentary trust. Additionally, the following information about wallets should be included: the type of wallet (whether online, cold, etc.), any devices on which wallets are stored, and the names of online wallet services used. Further, fiduciaries are limited by the Stored Communications Act and the Computer Fraud and Abuse Act in what online accounts they may access and how they may access them. Therefore,

⁴ <https://www.nolo.com/legal-encyclopedia/leaving-cryptocurrency-in-a-will.html>

language that the user consents to and authorizes the fiduciary's access to accounts and retention of account information, passwords, and private keys will be necessary.

SAMPLE WILL/TRUST LANGUAGE:

I leave all my cryptocurrency investments, crypto-coins, tokens, any other form of digital assets, or anything found in or on my cryptocurrency wallets to [insert name of beneficiary].

My cryptocurrency might be stored on digital wallets, cold wallets, online exchanges, or a combination of wallets and exchanges. The following items or devices might contain a cryptocurrency wallet: _____, _____, and _____. These items should not be distributed to any person until such time as the cryptocurrency, digital assets, or any information related to the access of my cryptocurrency is transferred to [beneficiary named above].

I have created a separate writing from this will that explains how to access my cryptocurrency wallets, and online cryptocurrency accounts. This document needs to be kept private as it contains the passwords, PINs, and private keys needed to access my cryptocurrency. This document will be stored with my other estate planning documents or [insert specified location(s)]. I intend to provide my executor/trustee full authorization to access the contents of any communication under the Stored Communications Act (currently codified as 18 U.S.C. §§ 2701 et. seq.) and such executor/trustee shall be an authorized user for purposes of applicable computer fraud and unauthorized computer access laws.⁵

If a client owning cryptocurrency doubts that the intended beneficiary has the technical skills to access cryptocurrency, another option exists. The executor of the estate or the trustee of the testamentary trust may exchange the cryptocurrency for cash and give the beneficiaries the value of the investment. This requires either an executor/trustee or a counseling estate planning attorney to have the technical skills to effect this transaction.

Creating a memorandum explaining the step-by-step process for accessing and using cryptocurrency is incredibly important. The memorandum will contain the security-sensitive information, such as account information and private keys. The probate process is a matter of public record, meaning that this sensitive information should not be included directly within the will. Because trusts do not go through probate, sensitive information may be stored within the trust document if the grantor has confidence in the trustee who will access the information. The memorandum should include a list of wallets and where those wallets are stored (whether on a

⁵ <https://www.nolo.com/legal-encyclopedia/leaving-cryptocurrency-in-a-will.html>

flash drive, online account, or other device), website URLs to exchanges that cryptocurrency may still be stored on, and account information, passwords, and private keys for each wallet. Because account information and passwords can be changed, make sure to update the memorandum accordingly.

When a client becomes incapacitated, and a power of attorney (POA) designates an attorney-in-fact to manage the client's legal and financial affairs, the attorney-in-fact will present the POA to the bank or other entity as proof of the client's consent for the attorney in fact to take over the assets. With cryptocurrency, showing this sort of proof document is not required because there is no central institution to which the POA can be presented. The fiduciary must have access to account information, passwords, and private keys in order to gain control of the wallets and cryptocurrency. Therefore a POA has limited practical use when it comes to cryptocurrency and cryptocurrency related accounts.

A POA may have limited practical use if the cryptocurrency is kept in a traditional financial institution, which may become increasingly common as banks adapt to cryptocurrency industry by offering cryptocurrency services. An additional situation in which POAs have practical use is if the cryptocurrency owner keeps a physical copy of their wallet's private key (such as stored on a flash drive or piece of paper) in a safety deposit box. In that case, a POA may be presented to the entity that holds or oversees the box, and the attorney-in-fact may access the private key and gain control over the wallet and cryptocurrency within. In these cases, the POA document should include provisions for control over the cryptocurrency itself *and* the private key and account information.⁶ This allows the attorney-in-fact to control cryptocurrency transactions and to manage the transfer of the private key if needed.

In the more formal sense, POAs may be necessary to show proof that an account holder consented to the attorney-in-fact's control over the cryptocurrency. The Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA) governs access to a person's online accounts when the account owner dies or becomes unable to manage the account and restricts the fiduciary's use of online accounts unless provided for otherwise in a will, trust, power of attorney, or other record. If an attorney-in-fact's use of the account holder's assets is legally challenged, it will be important to have record in the POA of the account holder's consent to the attorney-in-fact's use of the cryptocurrency.

SAMPLE POA LANGUAGE:

To handle on my behalf any of my digital assets "cryptocurrency," defined for purposes of this durable power of attorney as digital assets that are exchanged electronically and based on a decentralized network or exchange, with such exchanges not requiring a reliable intermediary and managed using distributed ledger [blockchain] technology. I give my attorney-in-fact the power to accept or pay on my behalf any cryptocurrency, digital asset currency, funds, or other value

⁶ For an example of language to use in a POA document, see James Kane, *Cryptocurrency and Digital Assets*, James M. Kane L. Blog (Aug. 6, 2019), <https://jameskanelegalblog.wordpress.com/2019/08/06/cryptocurrency-and-digital-assets/>.

that substitutes for currency from one person to another person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. The above term “other value that substitutes for currency” encompasses situations in which the transmission does not involve the payment or receipt of cryptocurrency, but does include, yet is not limited to, my private and public keys, blockchain and ledger information, bitcoins, bitcoin addresses, and any other cryptocurrency user or account data or information related to such transactions or to any convertible currency related thereto on my behalf.⁷

Conclusion

Cryptocurrency can be a daunting asset—many find it difficult to grasp the technology behind crypto and how to properly access, use, and protect it. However, because nearly 10% of American adults own cryptocurrency, estate planning attorneys will increasingly face clients who own these assets. When they do, estate planning attorneys will need to adapt their planning strategies around the unique features of cryptocurrency. By simply including cryptocurrency-specific provisions in a client’s estate planning documents, estate planning attorneys can ensure that their clients’ cryptocurrency properly passes to intended beneficiaries and does not become forever lost or inaccessible.

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⁷ <https://jameskanelegalblog.wordpress.com/2019/08/06/cryptocurrency-and-digital-assets/>.