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RUFADAA, Bitcoin and Fiduciaries: Finding the True Meaning of 'Digital Assets' in Estates and Trusts

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As life has increasingly moved online, fiduciary issues have followed. While in the past, a fiduciary was able to determine what assets were owned and how to value and manage them relatively simply, that simplicity has disappeared in the era of online bank and brokerage accounts, digital assets, cryptocurrency and non-fungible tokens (''NFTs''). A trustee now has an obligation to investigate and identify crypto assets, defined by the Federal Reserve as any digitized asset implemented using cryptographic techniques.[1] But what are the issues that trustees need to confront, and how should they be resolved?

I. WHAT ARE DIGITAL AND CRYPTO ASSETS?

Digital or crypto assets are any assets that ''exist in digital form and come with a right to use.''[2] Broadly defined, there are three main categories of digital assets: (i) information stored on a device, such as a computer, hard drive, phone, tablet, etc.; (ii) online accounts and rights to use, such as iTunes, email accounts, social media, photographs, access to information from financial and other providers, etc.; and (iii) assets that exist on the blockchain.

Regarding information stored on a device, consider items like resumes, photographs, presentations, documents, personal journals, and the like. For many people, these may have little to no economic value (although they may have significant sentimental value). However, a professional photographer may have photographs with significant economic value, and the unfinished novel by an established writer may also have monetary value. Many families would value nonprofessional photographs and writings created by a deceased family member regardless of their economic value, as they are priceless in the eyes of the family. In addition, contact lists and calendar entries (commonly found on an individual's phone) may also be very meaningful and helpful after a death.

Online accounts may be of particular importance following an individual's death, as a great deal of asset information is now found there, rather than the traditional locations such as mail or paper statements.

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[1] FRM Supervisory Letter SR-22/CA 22, *Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations* (Aug. 16, 2022), available at https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm.

[2] *Digital asset*, Wikipedia, https://en.wikipedia.org/wiki/Digital_asset#:~:text=A%20digital%20asset%20is%20anything.

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The ability to access banking and investment accounts via the internet has only been available to consumers since 1995.[3] While it took a few years for the concept of online banking to truly take hold, a 2019 survey conducted by the American Bankers Association found that roughly 73% of banking customers access their accounts via online and mobile platforms.[4]

Online banking and investment accounts are not the only online platforms that fiduciaries may need to access post-death. Another 2019 survey found that the average email address is connected to more than 130 online accounts in which digital asset and liability information might be stored.[5] While many digital accounts are unlikely to include asset and liability information (think social media accounts and accounts connected to e-commerce sites or online subscriptions), a fiduciary cannot be certain that all assets and liabilities have been accounted for without comprehensive access.

In addition to asset information that can be found in online accounts, email messages may hold significant sentimental value to a family following the death of the email account holder (user). One of the most prominent examples of this situation was the case of Lance Corporal Justin Ellsworth, a U.S. Marine who was killed in combat in Iraq in 2004. After his death, Lance Corporal Ellsworth's family wanted access to his Yahoo email account to preserve the messages he had sent and received during the periods he was deployed overseas. Yahoo initially refused to provide the access sought by the Ellsworth family, citing the click-through Terms of Service (''TOS'') agreement that Lance Corporal Ellsworth had ''signed'' when he created his Yahoo email account.[6] TOS agreements typically do not allow access to an account after a user's death because according to their terms, the Internet Service Provider (''ISP'') — Yahoo in this case — owns the servers and all the content that users store on those servers. Users, in turn, are granted a license to use space on the ISP's server, but the license expires when the user closes the email account or dies. As the content was never truly owned by the user, there is nothing for the user's family or a fiduciary to collect or secure. TOS agreements are governed by federal statutes that expressly prohibit the ISPs from granting access to anyone after a user has died, and that also prohibit any unauthorized access to the account post-death by anyone, including the fiduciary for a deceased user.[7] Nevertheless, after Ellsworth's family sued Yahoo in a Michigan probate court,[8] Yahoo agreed to turn over the contents of Lance Corporal Ellsworth's email account to his family, on CDs and in paper form, without ever allowing them to access the account. While the Ellsworth family ultimately got what they were asking for, the case established no meaningful legal precedent.[9]

Assets that hold economic value and may be located online only include various types of cryptocurrencies and NFTs, both of which exist exclusively on the blockchain. Cryptocurrency is defined as an ''encrypted data string that denotes a unit of currency. It is monitored and organized by a peer-to-peer network called a blockchain, which also serves as a secure ledger of transactions.''[10] An NFT is a financial security consisting of set of unique digital data stored in a blockchain, a form of distributed ledger. The ownership of an NFT is recorded in the blockchain and can be transferred by the owner, allowing it to be sold and traded.[11] Both cryptocurrency and NFTs may have independent economic value, but locating them after their owner dies and determining their value is anything but straightforward. As an example, Beeple's ''Everydays: The First 5000 Days'' is an NFT that sold at Christies for $69 million in March 2021.[12] Similarly, Jack Dorsey, a co-founder of Twitter, turned his first ever tweet into an NFT and sold it for $2.9 million in March 2021; the buyer of the NFT attempted to re-sell it in April 2022, but received no bids higher than $280.[13]

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[3] Wayne Thompson, *Wow! 20 Years of Internet Banking*, Wells Fargo: Wells Fargo Stories (May 18, 2015), https://stories.wf.com/wow-two-decades-of-banking-online/.

[4] Am. Bankers Ass'n, *ABA Survey: Customer Preference for Digital Banking Continues to Grow*. ABA Banking J. (Nov. 5, 2019), https://bankingjournal.aba.com/2019/11/aba-survey-customer-preference-for-digital-banking-continues-to-grow/ (retrieved Jan. 4, 2023).

[5] Nate Lord, *Uncovering Password Habits: Are Users' Password Security Habits Improving? (Infographic)*, Digital Guardian (June 5, 2017), https://digitalguardian.com/blog/uncovering-password-habits-are-users-password-security-habits-improving-infographic.

[6] Stefanie Olsen, *Yahoo Releases E-Mail of Deceased Marine*, CNET (Apr. 22, 2005), https://www.cnet.com/tech/tech-industry/yahoo-releases-e-mail-of-deceased-marine/.

[7] *Yahoo Terms of Service*, Yahoo!, https://legal.yahoo.com/us/en/yahoo/terms/otos/index.html.

[8] *In re Estate of Ellsworth*, No. 2005-296, 651-DE (Mich. Probate Ct.).

[9] Stefanie Olsen, *Yahoo Releases E-Mail of Deceased Marine*, CNET (Apr. 22, 2005), https://www.cnet.com/tech/tech-industry/yahoo-releases-e-mail-of-deceased-marine/.

[10] *Cryptocurrency*, Trend Micro, https://www.trendmicro.com/vinfo/us/security/definition/cryptocurrency#:~:text=A%20cryptocurrency%20is%20an%20encrypted.

[11] *Non-fungible token*, Wikipedia, https://en.wikipedia.org/wiki/Non-fungible_token.

[12] Scott Reyburn, *JPG File Sells for $69 Million, as 'NFT Mania' Gathers Pace*, N.Y. Times (Mar. 11, 2021).

[13] Jeff Kauflin, *Why Jack Dorsey's First Tweet NFT Plummeted*

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II. CORE TRUSTEE DUTIES THAT IMPACT CRYPTOCURRENCY AND DIGITAL ASSETS IN TRUSTS

A trustee has core duties that impact its holding and management of the trust assets. These are codified in the Restatement (Second) and Restatement (Third) of Trusts, which have been endorsed by many courts. Among the core trustee duties implicated by digital assets and cryptocurrency are the duty to take and keep control, the duty to preserve trust property and the duty to exercise reasonable care and skill.

Trustee's Duty to Take and Keep Control

The trustee is under a duty to the beneficiary to take reasonable steps to take and keep control of the trust property.[14] It is the duty of the trustee not only to take physical possession of the trust property, but in appropriate cases to see that it is designated as trust property.[15] Typically, if a corporate trustee is acting, it has custody of the assets. In some situations, it is proper for the trustee to put the beneficiary in possession of the property. For example, a beneficiary may occupy a residence titled in the name of the trust or have possession of tangible personal property.

Trustee's Duty to Preserve Trust Property

''The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill.'' *See Restatement of Trusts (Second)* §184 and *Restatement of Trusts (Third)* §227. Where, however, the loss to the trust estate is the result of the trustee's failure to use proper care or skill or where the loss is due to negligence, the trustee is liable to the beneficiaries for loss of such property (depending on state law and/or the provisions of the trust instrument). A trustee must also protect the property from theft, i.e., obtain insurance.

Trustee's Duty to Exercise Reasonable Care and Skill

''The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill.''[16] The standard is objective. Some states such as California impose a higher standard on corporate trustees. The trust instrument can, of course, alter this standard. For example, the trust instrument could state that the trustee shall not be liable for any action taken in good faith, provided he has not acted with gross negligence or willful default.

Prudent Investor Rule

In addition to core trustee duties, the trustee is responsible for the investment of trust assets, which is governed by the Prudent Investor Rule. Traditionally, a trustee had an obligation to invest the trust assets in a manner that was reflective of what a ''prudent man'' would do. Over the years, the courts have interpreted this standard to prohibit certain types of investments and to require certain strategies in the investment process, which was contrary to the standard's original intent of permitting more broad investment strategies.[17]

Eventually, the Restatement adopted a broader standard, known as the Prudent Investor Rule, which is codified in §90 of the *Restatement (Third) of Trusts* (2007). It states:

> The trustee has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements and other circumstances of the trust.

This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust. In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.

The Prudent Investor Rule, by its terms, remains subject to the trustee's other duties, including the duties of loyalty, impartiality, and acting with prudence in delegating any investment functions. The Prudent Investor Rule allows the trustee to consider risk and return in the context of the entire portfolio; it does not prohibit any given investment. The trustee has a duty to manage risk, not to avoid it.

99% in Value in a Year, Forbes (Apr. 22, 2022).

[14] *SeeRestatement (Second) of Trusts* §175 (Am. L. Inst. 1959). *See also Restatement (Third) of Trusts* §76 (Am. L. Inst. 2007).

[15] *See Scott on Trusts* §175 (Wolters Kluwer 1987).

[16] *Restatement (Second) of Trusts* §184; *Restatement (Third) of Trusts* §227.

[17] *See Restatement (Third) of Trusts*, Introductory Note to Ch. 17, *Investment of Trust Funds (Prudent Investor Rule)*.

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Under the Prudent Investor Rule, as laid out in the *Restatement (Third) of Trusts*, the trustee has the power, and may have a duty, to delegate some part or all the investment duties of the trustee: ''[i]n administering the trust's investment activities, the trustee has power, and may sometimes have a duty, to delegate such functions and in such manner as a prudent investor would delegate under the circumstances.''[18] The trustee does need to define the trust's investment objectives, but can do so with professional help. The trustee has a duty to act prudently in delegating any function and is required to exercise the appropriate level of care, skill, and oversight in investment delegation. The Restatement approach also judges a trustee's investment choices at the time the choices were made, not later in time based on the investment outcomes generated by the portfolio.

Section 227 of the *Restatement (Third) of Trusts* suggests a list of characteristics a trustee should consider in examining a contemplated investment. The trustee may wish to consider incorporating the suggested characteristics into an investment review checklist as part of the trustee's risk management plan.

Characteristics a Trustee Should Consider In Examining a Contemplated Investment[19]
1. Expectations concerning the investment's total return, and also the amount and regularity of the income element of that return whenever the beneficial interests or purposes supported by the trust are affected by distinctions between trust accounting income and principal.
2. The degree and nature of risks associated with the investment and the relationship of its volatility and characteristics to the diversification need of the portfolio as a whole.
3. The marketability of the investment, and the relation between its liquidity and volatility characteristics and the amount, timing, and certainty of the trust's cash flow or distribution requirements.
4. Transaction costs (including tax costs) and special skills associated with the acquisition, holding, management, and later disposition of the particular investment.
5. Any special characteristics of the investment that affect its risk-reward tradeoffs and effective return, such as exposure to unlimited tort liability, the presence and utility of tax advantages, and the maturity dates and possible redemption provisions of debt instruments.

In the absence of binding authority, some courts have looked to the rules set forth in the Uniform Prudent Investor Act (''UPIA'') as persuasive authority to offer guidance in a case involving allegations of breach of the duty to invest prudently. Like the Restatement, the UPIA establishes that fiduciaries be evaluated based on the whole portfolio, rather than on their individual investments.[20] The UPIA also varies the investment standard depending on the skill level of the trustee with respect to investments, which is a concept often expressed in case law.[21]

The UPIA, like the Restatement, sets forth a checklist of considerations that a trustee must consider when determining a proper investment portfolio for the trust.

Circumstances a Trustee Should Considerin Investing and Managing Trust Assets[22]
1. General economic conditions
2. The possible effect of inflation or deflation
3. The expected tax consequences of investment decisions or strategies
4. The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property
5. The expected total return from income and the appreciation of capital
6. Other resources of the beneficiaries
7. Needs for liquidity, regularity of income, and preservation or appreciation of capital
8. An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries

Under the UPIA, and subject to modification by specific directions provided in the trust instrument, the trustee generally has a duty to the beneficiaries to diversify the trust portfolio. This duty is not absolute and varies among jurisdictions. The trustee must be aware of the duty of impartiality and must properly balance growth and income where the trust creates these distinctions.

III. TRUSTEE ISSUE #1: HOW TO GAIN ACCESS TO DIGITAL ASSETS

In the era that preceded explosive growth in the use of digital storage for personal information, fiduciaries responsible for the post-death administration of estates and trusts (and the attorneys who represented them) relied primarily on income tax returns, personal files and papers stored in the decedent's home or office, and paper-copy documents, account statements, and tax reporting information to obtain asset and li-

[18] *Restatement (Third) of Trusts* §90 cmt. j.

[19] The list of considerations is taken verbatim from the *Restatement (Third) of Trusts* §227 cmt. k.

[20] *See* Uniform Prudent Investor Act §2(b) (Unif. Law Comm'n 1995).

[21] *Id.* at §2(f).

[22] The list of considerations is taken verbatim from the *Uniform Prudent Investor Act* §2(c) (Unif. Law Comm'n 1995).

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ability information. However, with increasing amounts of asset and liability information being stored electronically, these paper-based methods of information collection, while still important, are far less comprehensive than they once were.

In the present day, when a physical paper trail of asset and liability information is either incomplete or non-existent, the fiduciary will need to obtain electronic copies of documents that may be stored on personal computers, tablets, smartphones, in the cloud, or on some other digital storage mechanism. As nearly every digital storage device requires a password, the unavailability of the password needed to unlock the device could make it nearly impossible for a fiduciary to access critical information.

Using a password to unlock a digital storage device is unlikely to be a problem for a fiduciary, as long as the fiduciary has the password. However, accessing a digital information stored on servers that belong to commercial ISPs is more problematic, even with a password. This is because free email accounts and other free online accounts where personal information is typically stored (and all the data and digital information stored therein) that are available from ISPs such as Yahoo and Google — as the *Ellsworth* case discussed above illustrates — are typically owned by the ISP and licensed to the user for as long as the user is alive. Because these licenses typically expire upon the user's death, access to the account and all the digital data stored therein is ordinarily cut off as soon as the ISP learns of the user's death. This is true even if the fiduciary can access the account with the deceased user's username and password.

When a person goes online to create an account with an ISP, that person must ''sign'' a digital ''click-through'' TOS agreement. TOS agreements contain various provisions related to ownership, use and transferability of digital content stored on and accessed via the digital platform(s) owned by the ISP. For example, when a user ''signs'' a TOS agreement to create a free Gmail email account, Google grants a license to the user that is ''personal'' and ''non-assignable'' to anyone else, including, presumably, a fiduciary acting on behalf of the user.[23] Many TOS agreements for commercial ISPs are governed by the federal Stored Communications Act (''SCA'')[24] and Computer Fraud and Abuse Act (''CFAA'').[25] The SCA governs the actions of the ISPs and potentially subjects them to civil penalties and fines if they disclose the digital communications of their users without proper authorization. In most cases, fiduciaries cannot compel ISPs to disclose any digital communication governed by the SCA because doing so would violate the account holder's privacy and potentially subject the ISP to liability for each disclosure under the SCA. A simple example of a digital communication or record governed by the SCA is an email that a user sends from their Gmail account. If Google were to release a copy of that email to an unauthorized user, including the deceased user's fiduciary, Google would be in violation of the SCA and potentially subject to civil penalties.

The CFAA is a federal criminal statute that prohibits intentional access to a computer ''without authorization'' or in a manner that ''exceeds authorization'' provided for in the TOS agreement.[26] While fiduciaries have authority under state law to take possession or control of trust and estate assets, the licenses to access and use digital content stored by a digital content provider such as an ISP typically expire upon the death of the user. Because the licenses to use and access the digital content stored on ISP servers are typically personal and non-assignable to anyone else, including a fiduciary,[27] the CFAA (or a comparable state criminal statute) could potentially be used to prosecute a fiduciary who accesses a deceased user's account, even though access to the account may be necessary for the fiduciary to carry out its duties.

These conflicts between the federal statutes that govern click-through TOS agreements and the state statutes that govern the actions of fiduciaries led the Uniform Law Commission (''ULC'') to begin working on a uniform statute. The goal was to allow fiduciaries to gain access to asset information stored on digital platforms without subjecting them to liability for violations of the CFAA and other applicable state and local statutes governing unauthorized use of computers. The first attempt by the ULC, the Uniform Fiduciary Access to Digital Assets Act (''UFADAA''), sought to give personal representatives and executors implicit authority to access a decedent's digital asset information and accounts post-death, in much the same way that a fiduciary is authorized to open a decedent's mail following death.[28] Opposition to UFADAA was swift and overwhelming, as ISPs and privacy advocates were concerned that giving such broad authority to fiduciaries to access digital records

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[23] *Google Terms of Service*, Google Privacy & Terms (Jan. 5, 2022), https://policies.google.com/terms.

[24] 18 U.S.C.A. §2701.

[25] 18 U.S.C.A. §1030(a)–(c).

[26] *Id.*

[27] *Id.*

[28] Joseph Ronderos, *Is Access Enough? Addressing Inheritability of Digital Assets Using the Three-Tier System Under the Revised Uniform Fiduciary Access to Digital Assets Act*, 18 Tenn. J. Bus. L. 1032 (2017), available at https://trace.tennessee.edu/transactions/vol18/iss3/5.

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would undermine a decedent's privacy post-death.[29] While privacy was certainly a valid concern, the potential cost of complying with UFADAA likely caused much greater anxiety among the ISPs and tech companies that lined up to oppose it.

In response, the Revised Uniform Fiduciary Access to Digital Assets Act (''RUFADAA'') transpired as a compromise among privacy advocates, consumer advocates, the National Academy of Elder Law Attorneys, and the large tech firms that had staunchly opposed UFADAA.[30] The primary and most significant difference between RUFADAA and UFADAA is the requirement that users must consent to the disclosure of their digital communications before ISPs can be required to disclose any digital content to a fiduciary.[31] The language of RUFADAA provides for a three-tier system under which decedents may authorize access to their online accounts.[32]

The first (and most effective) tier of authorized fiduciary access is via an online tool agreement that the user executes (or ''clicks-through'') directly with the ISP. Such tools are separate and apart from the TOS agreements that govern the creation and use of the account, and the execution of the online tool agreement will effectively override any contrary direction by the user in a will, trust or other governing document.[33] Google, for example, allows its users to designate an individual to serve as an ''Inactive Account Manager'' who can access a deceased user's Gmail account for limited purposes and for a limited period of time following a user's death.[34] The Inactive Account Manager can be a family member, a close friend or a trusted advisor. It does not have to be the fiduciary responsible for post-death administration of the estate or trust.

The second tier for fiduciary access requires the user to include enabling language in their will or trust that specifically authorizes (or prohibits) disclosure to the fiduciary of digital asset information stored on the server of an ISP.

In the absence of an online tool or enabling language in the deceased user's will or trust, the third tier for fiduciary access is effectively the provisions of the TOS agreement itself. In most cases, this will mean no access.

In addition to understanding RUFADAA's three-tier system, fiduciaries must also know that RUFADAA defines of the term ''digital asset'' as ''an electronic record in which an individual has a right or interest,'' and that ''does *not* include an underlying asset or liability unless the asset or liability is itself an electronic record'' (emphasis added).[35] Knowing how RUFADAA defines the term ''digital asset'' is therefore important to understanding what *is not* deemed to be a digital asset under the statute. Because most of the underlying assets that fiduciaries will identify or uncover using the access afforded to them by RUFADAA will not be digital in nature, the definition also speaks to the limitations of RUFADAA. RUFADAA's definition of the term ''digital asset'' does not apply to virtual currency, NFTs, or other crypto assets that can only be accessed directly via the digital blockchain.

A simple example: An individual opens a bank account online using a smartphone application, funds the account via electronic transfers, receives monthly statements and other account notifications electronically, and accesses the account on a digital platform. To access the account information on the bank's digital platform, the account is linked to a personal email address that the account owner provided when the account was opened. The bank account itself *is not* a digital asset as defined by RUFADAA. However, the fiduciary who needs to collect and secure the account following the owner's death must know that the account exists and that it belongs to the deceased owner's estate or trust. Once the fiduciary has confirmed the existence of the account and how it was titled when the owner died, the steps to secure, value, and consolidate the assets into an estate or trust account are the same steps that a fiduciary would have followed in the pre-digital era. Accordingly, when ''underlying assets'' were excluded from the statutory definition of a ''digital asset,'' the drafters of RUFADAA acknowledged that most digital assets as defined by RUFADAA have little or no economic value, and that the statute itself is limited to providing access to digitally stored information *about* underlying assets, but not necessarily to the underlying assets themselves.

As fiduciaries are ultimately responsible for collecting and securing all the underlying assets in the estates and trusts that they administer, the growing absence of paper statements and documentation makes access to essential electronic records a much more

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[29] *Id.*

[30] *Id.*

[31] Jeffrey Levine, *RUFADAA and the Importance of Digital Estate Planning*, Kitces.com: Nerd's Eye View (Aug. 8, 2018), www.kitces.com/blog/rufadaa-digital-estate-planning-rights-three-tiers-online-tool-fiduciary/.

[32] *Id.*

[33] *Id.*

[34] *About Inactive Account Manager*, Google Account Help, https://support.google.com/accounts/answer/3036546?hl=en.

[35] *Revised Uniform Fiduciary Access to Digital Assets Act* §2(10) (Unif. L. Comm'n 2005), available at www.uniformlaws.org/viewdocument/final-act-with-comments-40?CommunityKey=f7237fc4-74c2-4728-81c6-b39a91ecdf22&tab=librarydocuments.

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critical component of post-death administration. Put differently, RUFADAA is designed to provide fiduciaries with access to the electronic paper trail that will hopefully lead the fiduciary to valuable underlying estate and trust assets which need to be collected, secured, valued and ultimately sold or distributed in accordance with the terms of the estate plan.

For online account users who do not employ an online tool agreement and do not include the necessary enabling language in their estate plan documents, RUFADAA will be of little or no value to their fiduciaries, who will be at the mercy of the terms of the clickthrough TOS agreement that likely terminated access to the online account immediately upon the user's death. Further, even if enabling language has been included in the decedent's will, the executor or personal representative will still need to know where or on what platform the deceased user kept their digital asset information. In addition, if the executor needs to rely on RUFADAA to obtain access to digital asset information that will be necessary to identify, collect and secure non-probate assets (assets titled in a revocable trust, for example), the executor may be required to initiate a formal probate proceeding even in situations where a formal probate may not otherwise be required. While some ISPs may accept a certified copy of the will as proof of authority, other ISPs may require additional documentation, like a court order, before they grant access to the decedent's accounts.[36]

As attorneys address these issues in estate plans, it is essential to include the appropriate RUFADAA language. Here is some sample language:

- My [executor] [trustee] shall have all power and authority: (a) to access, use, and control my digital devices, including but not limited to any digital device or data storage device or other medium of mine, such as personal computers, laptops, tablets, peripherals, mobile phones, smart phones, flash drives, remote servers, networks, cloud storage units, and any other digital hardware or storage device that currently exists or may exist in the future as technology develops; (b) to access, modify, archive, delete, control, and transfer and otherwise manage my digital assets, including but not limited to any files of mine, such as emails sent and received by me, documents, images, digital music, digital photographs, digital videos, software licenses, domain registrations and similar digital items which currently exist or may exist in the future as technology develops, that are created, produced, sent, communicated, shared, received or stored in the cloud or on a digital device, regardless of the ownership of such device; and (c) to access, modify, delete, control, continue, transfer and otherwise manage my digital accounts on any website, including but not limited to the following types of online user accounts of mine: social media, social network, blogs, listservs, online storage, file sharing, financial management, domain registration, domain name services, web hosting, tax preparation service, online stores, retail vendors, affiliate programs, gaming accounts, and loyalty programs. My [executor] [trustee] shall have the power to hire consultants and delegate to agents such of these powers and authorities as my [executor] [trustee] deems necessary to assist my [executor] [trustee] in decrypting electronically stored information of mine or in bypassing, resetting, or recovering any password or other kind of authentication or authorization.
- I hereby authorize any individual or entity that carries, maintains, receives, possesses, custodies, or controls any electronically stored information of mine, or that provides to me an electronic-communication service or remote-computing service, whether public or private, to divulge to my [Executor] [Trustee] at any time: (a) any electronically stored information of mine; (b) the contents of any communication of mine that is in electronic storage by that service or that is carried or maintained on that service; and (c) any record or other information pertaining to me with respect to that service. The terms used in this authorization are to be construed as broadly as possible.
- This authority granted to my [Executor] [Trustee] is intended to constitute ''lawful consent'' under the Electronic Communications Privacy Act of 1986, as amended, the Computer Fraud and Abuse Act of 1986, as amended, and any other applicable federal or state data privacy law or criminal law, and my [Executor] [Trustee] shall be deemed to be an authorized user for purposes of applicable computer-fraud and unauthorized-computer-access laws

IV. TRUSTEE ISSUE #2: HOW TO LOCATE VIRTUAL CURRENCY, NFTS AND CRYPTO ASSETS

Without sufficient information or documentation regarding virtual currency, NFTs or other crypto assets that are only accessible via digital blockchain technology, a fiduciary may have no knowledge of the existence of such assets, and their value may be lost forever to the beneficiaries.

[36] Betsy Simmons Hannibal, *The Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA)*, Nolo (Feb. 5, 2021), https://www.nolo.com/legal-encyclopedia/ufadaa.html.

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Unfortunately, there is no simple answer to the question of how to locate virtual currency, NFTs or crypto assets after the owner's death. Because there is no central repository and no help desk or other centralized authority, a fiduciary may only know about blockchain assets if the decedent has taken steps to ensure that the assets are discoverable. This issue highlights the need for planning in advance, as well as the need for all advisors to ask about blockchain assets when they begin working with a new client, and when they are preparing or updating estate plans for existing clients. Critically, for clients who hold these types of assets, the planning must include a discussion about how the digital wallets that hold these assets can be accessed and where the crypto keys, digital codes and passwords that are needed to access the wallets are physically stored. Because the crypto keys, digital codes and passwords may be stored on digital devices or in paper files that are typically distributed pursuant to provisions for disposing of tangible personal property, trust and estate planners will want to revise the tangible personal property provisions in wills and trusts to ensure that digital storage devices and paper files that may contain access to virtual currency, NFTs and crypto assets are not inadvertently distributed to a beneficiary in a manner that is not consistent with the intent of the grantor or testator.

V. TRUSTEE ISSUE #3: HOW TO TAKE CONTROL OF A DIGITAL ASSET OR CRYPTOCURRENCY

As noted above, a fundamental trustee duty is to take and keep control of trust property. For traditional assets, this is very straightforward — change the title, collect the asset, change the locks, etc. Trustees traditionally have rarely had to consider how to take and retain control of an asset after a death — the means of doing so was obvious. However, with digital assets and cryptocurrency, that is no longer true.

What does it mean to ''take and keep control'' of an asset that is not tangible and exists only on the blockchain? We know that ownership of digital assets that live on the blockchain (whether cryptocurrency or NFTs) is based not on titling of documents, but rather on holding the private key that reflects ownership.

The initial owner was given the key originally, but then must decide where to keep the key.

The general advice from experts is that the safest location is so called ''cold storage,'' meaning storage someplace that is not attached to the internet (as opposed to ''hot storage,'' which is a location that is attached to the internet, and thus is considered less secure). For example, cold storage might include placement in a safe deposit box or a secure location in the owner's home, or on a digital storage device that does not connect to the internet. Hot storage might include retention on a cell phone or in a password manager application.

Beyond the owner deciding about where to store digital assets, there is a separate question of how to pass the needed information upon death or disability. Because there is no central authority, there is no way to ask someone for access. Instead, it is essential that the owner plan for how to pass on the keys, regardless of how they are held. The key should never be included in a document that will be widely viewed, including a will that will be seen by many people and may be filed with the local court or registrar of wills. Query: If the key is given to one individual, does that person become the ''owner'' of the digital asset? If you analogize with bearer bonds, which are arguably very similar, that may well be the case.

The best option, if the owner is amenable, is to deposit the crypto asset with a custodian like Coinbase. Coinbase is among a handful of commercial providers that operate cryptocurrency exchange platforms on which clients can buy, sell and custody their cryptocurrency holdings in accounts that are similar to investment brokerage accounts. Because these platforms function like traditional brokerage accounts, they allow for easier valuation and transfer of virtual currency at death.

Once the owner works out how to transfer key to the trustee, the trustee must determine how to safeguard the key. This is a particular issue if the key is given to a corporate fiduciary or a law firm, where there is the potential (and perhaps even the likelihood) that multiple people will have access to the key. How does the named trustee ensure that no one misuses the key? Consider sub custodians that require multiple layers of authentication from multiple people who have authorization. If that is not practical, ensure there is a process and procedure in place to protect the key until it is needed.

VI. TRUSTEE ISSUE #4: HOW TO VALUE CRYPTOCURRENCY AND DIGITAL ASSETS

The term crypto*currency* is typically used to describe Bitcoin, Ethereum and other so-called virtual *currencies* that are traded via digital blockchain technology, held for investment, and more and more frequently are being used for the purchase and sale of goods and services in the so-called ''real'' economy. However, because these currencies do not have legal tender in any jurisdiction, the IRS has stated affirmatively that: ''Virtual currency is treated as property for

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federal income tax purposes.''[37] As such, the estate tax value of virtual currency will be its ''fair market value'' as of the date of the owner's death or on the alternate valuation date should the fiduciary elect to use alternate valuation on the federal estate tax return.

''Fair market value'' is defined as ''the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.''[38] Since virtual currencies are traded on public exchanges, calculating their fair market value for federal estate and gift tax purposes is analogous to calculating the fair market value of marketable securities like stocks, bonds and mutual funds that are also traded on public exchanges. The fair market value of publicly traded securities is determined by calculating the average between the highest and lowest quoted selling prices for the security during the trading day that corresponds with the date of death, the alternate valuation date, or in the case of a lifetime gift, the date of the gift.[39] The difference between marketable securities and virtual currency, however, is that exchanges where marketable securities are traded typically open in the morning, close in the afternoon and are not open on weekends and holidays.

Virtual currency markets and exchanges, on the other hand, never close. Since virtual currency can be traded 24 hours a day, seven days a week, calculating the average between the highest and lowest quoted selling prices as of the date of death is not possible. The IRS has therefore issued guidance through an expanded list of Frequently Asked Questions (FAQs) attached to the initial guidance it had issued in Notice 2014-21. Specifically, the IRS takes the position that the fair market value of cryptocurrency received in a transaction facilitated by a cryptocurrency exchange is ''the amount the cryptocurrency was trading for on the exchange at the date *and time* the transaction would have been recorded on the ledger'' if the transfer had been recorded on the blockchain ledger.[40] For cryptocurrency received in a peer-to-peer transfer that is *not* facilitated by, or recorded on the ledger of, a cryptocurrency exchange (e.g., an estate or trust beneficiary receives the crypto key from the fiduciary as a part of their distribution), the IRS will allow the fiduciary to use evidence of the so-called ''explorer value'' as of the date *and time* of the transfer.[41] The explorer value is determined ''by a cryptocurrency or blockchain explorer that analyzes worldwide indices of a cryptocurrency and calculates the value of the cryptocurrency at an exact date and time.''[42] Based on this guidance, a fiduciary who needs to calculate the estate tax value of virtual currency following the owner's death will need not only *the date* of death, but also the precise *time* at which the death occurred. Further, if the fiduciary intends to use the ''explorer value,'' the fiduciary will need to identify and use one (or more) of the blockchain explorer programs to calculate the estate tax value of any virtual currencies that are includable in the decedent's gross taxable estate. Blockchain explorer programs are online blockchain browsers that can show the details of all transactions that have ever happened on a blockchain network or on a series of blockchain networks, depending upon the type or brand of virtual currency that the fiduciary will need to value.[43]

NFTs, like virtual currencies, are traded on the blockchain, and information about prior transactions involving specific NFTs will typically be accessible to the public. While the IRS has provided formal guidance on the estate tax treatment of virtual currency, there has been no guidance on the estate tax valuation of NFTs. Nevertheless, fiduciaries still must determine and report the fair market value of each includible NFT as of the date of death or alternate valuation date.[44]

Like marketable securities and virtual currency, NFTs are intangible assets. However, because each individual NFT is unique and separately identifiable from similar or even the same tokenized works, NFTs are likely more analogous to artwork and other items of tangible personal property when it comes to determining their fair market value for estate tax purposes.[45] The regulations regarding the estate tax valuation of artwork and tangible personal property state that ''articles having marked artistic or intrinsic value'' that exceeds $3,000 must be appraised by qualified experts.[46] The required written appraisals must be attached to the federal estate tax return. Each written appraisal report should include an itemized list

[37] IRS Pub. 544, *Sales and Other Dispositions of Assets* (Feb. 16, 2021), https://www.irs.gov/pub/irs-pdf/p544.pdf. *See also* IRS Notice 2014-21 (Apr. 4, 2014).

[38] Treas. Reg. §20.2031-1(b).

[39] Treas. Reg. §20.2031-2(b)(1).

[40] IRS Notice 2014-21, Q-26.

[41] *Id.*, Q-27.

[42] *Id.*

[43] Brian Nibley, *What Is a Blockchain Explorer? Guide to Block Explorers*, SoFi Learn (Nov. 23, 2021), https://www.sofi.com/learn/content/blockchain-explorer/.

[44] Treas. Reg. §20.2031-1(b).

[45] Matthew Erskine, *Uncertainty inthe Valuation of Non-Fungible Tokens*, Forbes (Feb. 2, 2022), https://www.forbes.com/sites/matthewerskine/2022/02/02/uncertainty-in-the-valuation-of-non-fungible-tokens/?sh=296d2a4b6ddd.

[46] Treas. Reg. §20.2031-6(b).

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of the property that is the subject of the appraisal, and detailed descriptions of each item of property and its separate estate tax value. Each appraisal must also state the valuation methodology, include a detailed and specific statement of the appraiser's qualifications, and affirm that the appraiser is an independent and disinterested party with respect to the property that is the subject of the appraisal.[47] The regulations go on to state that ''expert appraisers'' must be ''reputable and of recognized competency to appraise the particular class of property involved.''[48]

Assuming that the analogy to artwork and other tangible personal property is appropriate for determining the fair market value of NFTs for estate and gift tax purposes, it is far from perfect. In most cases in which professional appraisers are needed to determine the fair market value of tangible property for federal estate tax or gift tax purposes, fiduciaries and practitioners often find that there are experts and specialists for nearly every type of tangible personal property imaginable, even for some of the rarest and most obscure collectibles. In addition to fine art, jewelry and antiques, there are professional appraisers with deep and specific expertise in rare books, sports memorabilia, stamps and coins, classic cars, fine wine, old toys, Christmas tree ornaments and even vintage advertising signs, to name just a few.

Unlike NFTs (which have only existed since 2014 and did not begin trading in earnest until 2017),[49] most types of tangible personal property that require estate and gift tax appraisals have existed in one form or another for generations, and often have unique physical characteristics that are recognizable and detectible to experienced experts who must also authenticate them in order to value them. In addition, the markets for most types of tangible property, including the smallest and most obscure of those markets, produce data (both historical and current) that, when analyzed by experienced valuation specialists, can be used to support the finding of a fair market value that is objectively accurate, or at least defensible, for federal estate and gift tax purposes. Because NFTs are so new, there is not nearly as much market data available as there is for fine art and jewelry. The relatively short history of NFTs would also indicate that there cannot (yet) be an abundance of professional appraisers with enough experience to hold themselves out as qualified NFT valuation experts. While that is likely to change over time as the NFT industry continues to grow, identifying and securing qualified valuation experts to appraise NFTs for estate and gift tax purposes is likely to create significant challenges for planners and fiduciaries for the foreseeable future.

While each NFT has unique digital characteristics that make it distinguishable from other NFTs, NFTs also possess certain characteristics that make them very different from tangible or physical collectibles. An NFT is a unique and one-of-a-kind digital token, but the real-world image, videoclip or object to which that unique digital token is attached may be easily accessed or even replicated by anyone with an internet connection. The fair market value of an NFT will also be affected by the terms of the smart contract that governed the initial sale of the NFT by the creator to the initial buyer.[50] A smart contract is programming or data that exists within the blockchain and enables the network to store information about NFT transactions.[51] The smart contract is designed to keep the information about the transaction accessible and transparent, while at the same time preventing anyone from changing or modifying it.[52] Because the smart contract is a software application that is created when the NFT is created or ''minted,'' it is programmed to include the specific rights that are being sold to the current or future buyers, to verify the authenticity of the NFT, to prevent counterfeiting, to facilitate future sales or transfers of the NFT, and to handle royalty payments, among many other things.[53] Accordingly, obtaining the fair market value of an NFT will require a valuation expert who can review, understand and evaluate the terms of the smart contract attached to the NFT.

Even though NFTs are intangible and traded on public exchanges, calculating the fair market value of any asset requires the valuation expert to look to the most relevant market or the market in which the asset is most commonly sold to the public.[54] For NFTs, finding the most relevant market will be determined by, among other things, the specific nature of the NFT, the online marketplace on which the NFT may be listed, the terms of the smart contract to which it is attached, *and* perhaps also determined by historic and current data about sales of comparable NFTs. These characteristics, along with an increasing amount of data accumulating daily from auctions and other sales of NFTs, support the argument that NFTs should be valued for estate tax purposes in a manner that is like the method for valuing fine art and collectibles. How-

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[47] Treas. Reg. §20.2031-6(d).

[48] *Id.*

[49] Jolene Creighton, *NFT Timeline: The Beginnings and History of NFTs*, NFT Now (Dec. 15, 2022), https://nftnow.com/guides/nft-timeline-the-beginnings-and-history-of-nfts/.

[50] Alex Gomez, *What Is an NFT Smart Contract? (Simply Explained)*, CyberScrilla (Apr. 15, 2022), https://cyberscrilla.com/nft-smart-contracts-explained/.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

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ever, unless and until the IRS issues formal guidance on how to value NFTs for estate and gift tax purposes, the proper valuation method for NFTs will remain uncertain.

VII. TRUSTEE ISSUE #5: HOLDING DIGITAL ASSETS AND CRYPTOCURRENCY IN TRUSTS

The Prudent Investor Rule applies to all trusts (although versions vary by state). That means the trustee has an obligation to invest based on the purposes, terms, distribution requirements and other circumstances of the trust. In most cases, this will include taking the long view on investing, ensuring that the overall portfolio is invested prudently.

Cryptocurrency in particular presents significant challenges given the Prudent Investor Rule. To start, cryptocurrency is very volatile — its weekly volatility is four times higher than stocks and 26 times higher than bonds. As an example, Bitcoin had an annualized volatility rate of 81% in 2021, which meant that investors could expect an *average* daily change in value of 4%.[55]

In addition, crypto assets are not secure. According to Chainanalysis, more than one-third of all bitcoin exchanges have been breached.[56] The technology that keeps cryptocurrency secure and anonymous also makes it easier to hack. Digital wallets, especially those maintained by exchanges, have been the biggest sources for attacks. In 2021, investors lost $14 billion in cryptocurrency fraud.[57]

As a result, it is not clear yet if crypto fits into a prudent investor portfolio – but most trustees seem to think the answer is no. Given its volatility, cryptocurrency is not a risk control asset (like bonds) but there is no expected return on cryptocurrency, which is true of risk assets (like stocks). Cryptocurrency seems to be closest to a highly speculative commodity, which would rarely, if ever, be included in a trust portfolio. Given the naturally conservative approach to investing trusts, it seems unlikely that most trustees will include cryptocurrency (or other digital assets) in their trust portfolios.

Finally, at least for corporate fiduciaries, the custody environment for these assets has not been clarified, and so trust companies must keep in mind the everchanging nature of this area. For instance, the SEC's treatment of crypto assets differs from the existing accounting treatment of safeguarded assets held in a custody account, which are not reported on the custodian's balance sheet.[58]

VIII. TRUSTEE ISSUE #6: HOW CRYPTOCURRENCY IS TREATED FOR INCOME TAX PURPOSES?

As noted above, the IRS has stated very clearly that virtual currencies are treated as property for federal income tax purposes.[59] Accordingly, when a person purchases virtual (crypto) currency, the purchase price will typically set the person's cost basis. If the person then sells or exchanges their virtual currency for cash or assets with a fair market value that exceeds the adjusted basis, that person will have taxable gain that must be reported on their income tax return for the year in which the sale or exchange occurred. Conversely, if the person sells or exchanges their virtual currency for cash or other assets with values that are *lower than* their adjusted basis, the person can report a loss.[60] In determining the character of realized gains and losses on the sale of virtual currency, the same rules apply as for stocks, bonds and other investment property.[61] Specifically, gains or losses on the sale or exchange of virtual currencies held by a taxpayer for more than a year will be treated as long-term gains or losses while sales or exchanges of such currencies held for less than a year will generate short-term gains or losses.[62] The income tax treatment of gains and losses on sales or exchanges of virtual currency and NFTs held for investment purposes is logical to people who regularly invest in marketable securities and other assets, and who may have purchased Bitcoin or other virtual currencies for investment purposes.

For people who have received virtual currency as payment for goods or services they have provided, and for people who have purchased goods or services with such currency, the income tax implications may come as a surprise. Since their inception, Bitcoin and other virtual currencies have been promoted as substitutes for currency that is legal tender in one or more jurisdictions around the world. For this reason, many people tend to think of virtual currency as actual cur-

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[55] Martin Armstrong, *The Varying Volatility of Cryptocurrencies*, Statista Infographics (June 7, 2022), www.statista.com/chart/27577/cryptocurrency-volatility-dmo/#:%7E:text=As%20revealed%20in%20the%20Digital,change%20on%20a%20daily%20basis.

[56] *Crypto Crime Trends for 2022: Illicit Transaction Activity Reaches All-Time High in Value, All-Time Low in Share of All Cryptocurrency Activity*, Chainalysis (Jan. 6, 2022), https://blog.chainalysis.com/reports/2022-crypto-crime-report-introduction/.

[57] *Id.*

[58] Staff Accounting Bulletin No. 121, SEC (Apr. 11, 2022), https://www.sec.gov/oca/staff-accounting-bulletin-121.

[59] *See* above n. 37.

[60] IRS Notice 2014-21, Q-6.

[61] *Id.*, Q-7.

[62] IRS Pub. 544, *Sales and Other Dispositions of Assets* (Feb. 16, 2021), https://www.irs.gov/pub/irs-pdf/p544.pdf.

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rency that can be spent or received in the same way that one would spend or receive dollars, euros, pesos, or shekels. However, selling or purchasing goods and services using Bitcoin or other virtual currency as if it is actual currency can result in significant negative income tax consequences.

By way of example: Assume that a person provides a service for which payment is typically made in cash. Instead of being paid in cash, however, the service provider accepts a payment of one Bitcoin from the client. Assume further that when the payment of one Bitcoin is received, it has a fair market value of $10,000. Accordingly, the person who performed the service will have to report and pay tax on $10,000 of ordinary income.

Now assume that rather than converting the Bitcoin to cash immediately after receiving it, the service provider holds onto the Bitcoin. Fast forward a few months, and the provider learns that the fair market value of one Bitcoin has increased from $10,000 to $50,000. At this point, the service provider, in need of a new car, sees an ad for a car dealership that is selling a new car for the equivalent of one Bitcoin, and is willing to accept payment in Bitcoin. The service provider purchases the car from the dealership and pays for it by transferring one Bitcoin directly to the car dealership. Because the Bitcoin was worth $10,000 when it was transferred to the provider as payment for services rendered, and because it was worth $50,000 when the service provider transferred it to the dealership to purchase the car, the transfer of the Bitcoin to the dealership results in a taxable gain of $40,000 for the service provider. While the service provider may be thrilled to learn that the Bitcoin received as payment for services rendered has quintupled in value over a relatively short period of time, they may also be shocked to learn that they must now pay income tax on the $40,000 gain that was realized when the car was purchased.

It is ultimately the responsibility of the individual taxpayer to report the amount of ordinary income received in the form of virtual currency and to report any gains or losses that are realized from any sales or transfers of virtual currency. However, the nature of virtual currency is such that sales and transfers are not typically reported to the IRS on Forms 1099 in the same way that cash payments, sales and transfers of marketable securities and other reportable income and losses get reported to the IRS *and* to the taxpayer. It is for this reason that beginning with tax year 2021, the IRS added the following mandatory question to the top of IRS Forms 1040, 1040-SR and 1040-NR:[63]

> At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? ☐ Yes ☐ No

The question applies to all taxpayers and initially, it created some confusion for those who may have owned or purchased virtual currency during the tax year in question, but did not ''receive, sell, exchange, or otherwise dispose of'' virtual currency during that year. To alleviate some of this confusion, the IRS issued guidance stating that taxpayers can check the ''No'' box if their transactions involving virtual currency were limited to holding virtual currency in their own wallet or account, transferring virtual currency between their own wallets or accounts, and/or purchasing virtual currency with real currency during the tax year for which the return is being filed.[64]

Taxpayers who did ''receive, sell, exchange, or otherwise dispose of'' virtual currency during the tax year for the which the return is being filed must check the ''Yes'' box on their personal income tax returns. For further clarification, the IRS published the following list of the most common transactions in virtual currency that will require a taxpayer to check the ''Yes'' box:

- The receipt of virtual currency as payment for goods or services provided.
- The receipt or transfer of virtual currency for free (without providing any consideration) that does not qualify as a bona fide gift.
- The receipt of new virtual currency because of mining and staking activities.
- The receipt of virtual currency due to a hard fork.
- An exchange of virtual currency for property, goods, or services.
- An exchange/trade of virtual currency for another virtual currency.
- A sale of virtual currency.
- Any other disposition of a financial interest in virtual currency.[65]

The IRS added the question about virtual currency to the top of page one of IRS Forms 1040, 1040-SR and 1040-NR to make it clear to taxpayers that they must report these transactions to the IRS even though there may be no automated or mandatory reporting by any other party to the transactions, by any custodian of their virtual currency, or by any electronic ledgers on which the transactions are recorded. Put differ-

[63] *IRS Reminds Taxpayers They Must Check a Box on Form 1040, 1040-SR or 1040-NR on Virtual Currency Transactions for 2021*, IR 2022-61 (Mar. 18, 2022), https://www.irs.gov/newsroom/irs-reminds-taxpayers-they-must-check-a-box-on-form-1040-1040-sr-or-1040-nr-on-virtual-currency-transactions-for-2021.

[64] *Id.*

[65] *Id.*

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ently, if a taxpayer has engaged in any of these potentially taxable transactions during the tax year, and checks the ''No'' box, the taxpayer will open the door to charges of tax fraud because they will have lied on an official government document that is signed under penalties of perjury.[66] While checking the ''Yes'' box is likely to mean that the return will be flagged for further review by the IRS, it is always better to disclose the activity and risk reporting the income incorrectly than it is to deny that the transactions occurred and hope that the IRS does not somehow figure it out. Disclosing the transactions and reporting the income incorrectly may still result in interest and underpayment penalties for taxpayer. However, failing to disclose the transactions, in addition to the potential for interest and penalties, could also open the taxpayer up to criminal charges for tax fraud.[67]

In addition to the IRS guidance and the new virtual currency question on personal income tax returns, the Infrastructure Investment and Jobs Act,[68] signed into law by President Biden in November 2021, includes expanded reporting requirements that apply to income tax returns filed after December 31, 2023.[69] Most notably, brokers and dealers who engage in transactions involving the purchase, sale or other disposition of virtual currency and NFTs will be required to report those transactions on Forms 1099 that must be provided to the IRS and the taxpayers who are required to report the taxable income generated or realized from these transactions.[70] At this point, the definition of the term ''broker'' for virtual currency and NFTs is problematic because so many of the cryptocurrency exchanges on which these assets are traded are fully automated and often lack any type of centralized management of their platforms. Further, many of the automated exchanges do not currently collect from individuals and entities who trade on their platforms, the kind of personally identifiable information (e.g., a certified taxpayer identification number or TIN) that will be needed to report transactions on Forms 1099.[71] Accordingly, practitioners should remain on the lookout for additional guidance from the IRS or perhaps even clarifying legislation as the December 31, 2023, deadline for compliance draws closer.

IX. TRUSTEE ISSUE #7: HOW SALES OF NFTs AND OTHER EARNINGS ON NFTs ARE TREATED FOR INCOME TAX PURPOSES

Like virtual currency, NFTs are treated as property for purposes of calculating gains or losses when they are bought, sold, or exchanged on secondary markets. As discussed above, cryptocurrency and NFTs can both be classified as intangible assets because they are traded on public exchanges. However, as noted above, each individual NFT is unique and separately identifiable from similar or even the same tokenized works or objects. As a result, NFTs possess characteristics that in certain ways, would indicate that NFTs have more in common with fine art and other items of tangible personal property than they do with cryptocurrency, at least when it comes to calculating an owner's basis in an NFT. Accordingly, it follows that when an individual or entity purchases an NFT, the purchase price will establish the buyer's basis in the NFT. Further, when the purchaser subsequently sells the NFT, the realized gain or loss will amount to the difference between the amount for which the seller purchased the NFT and the amount of the proceeds received from the subsequent sale. As for the gain or loss on the sale, it will be characterized as long-term if the seller held the NFT for more than a year, and short-term or ordinary if the seller owned the NFT for less than a year.[72]

The income tax treatment of gains and losses from the sales or exchanges of NFTs on secondary markets is virtually the same as it is for gains and losses from sales or exchanges of other tangible and intangible assets purchased and held for investment purposes. However, gains and losses from sales on secondary markets is not the only way that NFTs can generate taxable income or loss for a taxpayer. When a new NFT is created or minted, the creation of the new NFT is not a taxable event for the taxpayer who minted it. However, the proceeds from the initial sale of a newly minted NFT, reduced by the costs associated with creating the NFT and any applicable trading fees, will be taxed as ordinary income to the creator

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[66] Kate Dore, *There's a Tricky Cryptocurrency Question on Your Tax Return. 'You're Playing With Fire if You Don't Report It'*, CNBC (Mar. 23, 2022), https://www.cnbc.com/2022/03/23/theres-a-tricky-virtual-currency-question-on-your-tax-return.html.

[67] Kate Dore, *'You're Playing With Fire if You Don't Report It.' What Happens if You Don't Disclose Crypto Activity This Tax Season*, CNBC (Feb. 8, 2022), https://www.cnbc.com/2022/01/25/what-happens-if-you-dont-disclose-crypto-activity-this-tax-season.html.

[68] Pub. L. No. 117-58 (Nov. 15, 2021).

[69] Erin Fennimore, *How Does the U.S. Infrastructure Bill Affect Tax Compliance for Digital Asset Brokers and Individuals?* TaxBit (Aug. 18, 2022), https://taxbit.com/blog/the-infrastructure-bill-has-passed-whats-next-for-crypto.

[70] *Id.*

[71] *Id.*

[72] Arthur Teller, *The Essential NFT Tax Guide for Creators and Investors*, TokenTax (Aug. 16, 2022), https://tokentax.co/blog/nft-tax-guide.

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in the year in which the sale occurs.[73] The amount of tax owed by the creator will depend upon the creator's federal income tax bracket. Currently, the top federal income tax rate for individual taxpayers is 37%, but the self-employment tax base rate of 15.3% will also apply for self-employed creators, as will any state and local income taxes imposed by the state in which the creator resides.[74]

Because NFTs are often purchased and sold using cryptocurrency, the income tax implications for buyers and sellers may not be limited to calculating realized gains and losses on a particular sale. A purchaser who buys an NFT with cryptocurrency that has appreciated in value will be liable for capital gains tax on the increase in the value of the cryptocurrency that occurred between that date the purchaser acquired the cryptocurrency and the date the purchaser used the cryptocurrency to buy the NFT.[75] Similarly, for an NFT seller who receives cryptocurrency in exchange an NFT, in addition to calculating the realized gains or losses on the NFT sale itself, the seller must also account for any gains or losses realized due to any change in the value of the cryptocurrency that the seller may have used when originally purchasing the NFT.[76] For example, assume that the seller purchased an NFT for three Bitcoins, when individual Bitcoins were trading at $5,000 each, for a total purchase price of $15,000. The seller later sells the same NFT for four Bitcoins at a time when one Bitcoin was valued at $5,500, thereby receiving gross sale proceeds of $22,000. The seller in this transaction must therefore recognize a total taxable gain of $7,500 ($7,000 of gain on the sale of the NFT plus the net $500 increase in the value of the one additional Bitcoin that the seller received in exchange for the NFT).[77]

In addition to ordinary income that the creator of an NFT realizes on the initial sale, NFT artists and content creators may also receive royalties on the future sales and use of the NFTs they created. Royalties from NFTs typically give the original owner of the NFT a percentage of the sale price each time an NFT created by the original owner is subsequently sold or resold on an NFT marketplace.[78] The average NFT royalty ranges from 5%–10% of the proceeds of each subsequent sale. Creators of NFTs can choose their royalty percentage for each NFT they create. The royalty percentage is then written into the smart contract for the NFT in question, so that royalty payments are automatically paid to the creator upon each subsequent sale in the secondary market.[79] Like royalties on copyrights, patents and other types of intellectual property, royalty payments on subsequent sales of NFTs will be taxed as ordinary income to the creator.[80]

X. TRUSTEE ISSUE #8: HOW TO ADVISE ATTORNEYS/CLIENTS TO PLAN FOR DIGITAL ASSETS AND CRYPTOCURRENCY

Given all the uncertainty around digital assets, what is a fiduciary to do? First and most simply, encourage clients to PLAN!

- Encourage clients to set up ''Inactive Account Manager'' or its equivalent for their personal email accounts so that their personal emails can be accessed post-death to search for asset and liability information that will be needed by their fiduciary.
- Include RUFADAA enabling language in all wills and trusts.
- Include a question about digital assets & cryptocurrency in your planning or intake questionnaire.
- Ask about types of cryptocurrencies owned, how they are held, if there are other digital assets, etc. Discuss the issue of locating digital assets during a meeting with the client. Many clients may think this does not apply to them if they don't own crypto or NFTs — but it could apply if they have valuable pictures, emails, etc.Think about how to transfer keys to cryptocurrency. Consider a custodian like Coinbase.
- Include a clear definition of blockchain assets.Add language to the tangible personal property provisions to ensure that digital storage devices and paper files that may contain information required access to blockchain assets (cryptocurrency, NFTs, etc.) get distributed separately from other items of tangible personal property. In the absence of separate language, blockchain assets

[73] Dan Wright, *NFT Taxation — An Introduction to the Federal Income Tax Implications of Creating or Investing in NFTs*, Clark Nuber PS (Apr. 26, 2022), https://clarknuber.com/articles/nft-taxation-introduction-federal-income-tax-implications-creating-investing-nfts/.

[74] *Id.*

[75] IRS Notice 2014-21, Q-7.

[76] *Id.*

[77] *See id.*

[78] Kent Thune, *What Are NFT Royalties & How Do They Work?*, Seeking Alpha (May 27, 2022), https://seekingalpha.com/article/4483346-nft-royalties.

[79] *Id.*

[80] Matthew Erskine, *The Income Taxation of Creators, Investors, Dealers and Collectors of NFTs*, Forbes (Jan. 19, 2022), https://www.forbes.com/sites/matthewerskine/2022/01/19/the-income-taxation-of-creators-investors-dealers-and-collectors-of-nfts/?sh=446b46adf600.

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may end up being distributed with the decedent's tangible personal property in a manner that is *not* consistent with the intent of the grantor or testator.

- Include language permitting investments in blockchain assets (if desired). This may be helpful to include in case these assets are owned by the decent at death, so the fiduciary can manage them as needed.
- Consider transferring cryptocurrency or digital assets into an LLC. Entities can provide protection and ensure that control remains where the grantor prefers. Transfer is much easier because the asset being transferred is a unit of the entity, rather than the cryptocurrency or digital asset. The issue regarding safekeeping of the digital asset key remains regardless of ownership, but the use of the key may be reduced. If someone other than the trustee has investment responsibility and the beneficiaries wish to retain the cryptocurrency or digital asset, the manager of the LLC can decide to do so without impacting the trustee's prudent investor responsibilities.
- Use a directed trust to hold the LLC interest. If the administrative trustee has no investment responsibility, the Investment Advisor/Director can choose to retain the cryptocurrency or digital asset without running afoul of the administrative trustee. While the administrative trustee won't object, most state directed trust statutes require the Investment Advisor/Director to be a fiduciary. Query: Should that individual be comfortable retaining the asset as a fiduciary? Like the use of an LLC, the administrative trustee will not have Prudent Investor Rule concerns.
- Talk to nominated executors, personal representatives, and successor trustees about their comfort level with the approach being planned or considered.

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