Taxation and Estate Planning for Cryptoassets

Andrew M. Hinkes, Esq.

Chicago Estate Planning Council

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What we’ll cover:

1. Cryptoasset Basics
2. US taxation of cryptoassets
3. Estate planning basics

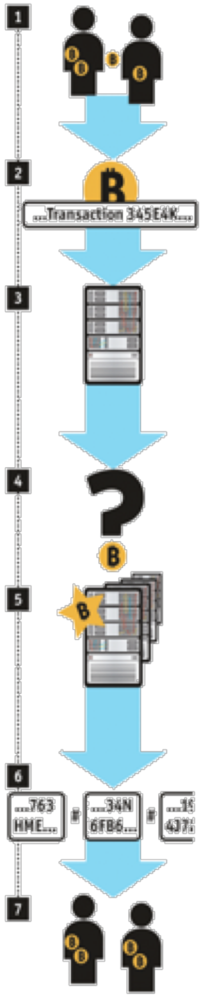
Bitcoin as the model

Bitcoin: Digital Cash

Decentralized, peer-to-peer value transfer system

- Announced in late 2008 by "Satoshi Nakamoto"
- Key Innovation: Participant consensus, no trusted third party
- Hashing/Cryptography used:
    - To "ensure" validity of transactions submitted
    - To make "confirmation" of transactions expensive, secure
- Users identified/participate by cryptographic keys pairs called "wallets"
- Native state is escrow- transactions "break escrow"
- Tokens have no native physical form
- "Pseudo-anonymous" traceable transactions

How a Blockchain Processes Transactions:



A blockchain is a virtual, decentralized ledger that records everything in a secure and transparent manner

Step 1: Two parties wish to conduct a transaction. The Payer initiates a value transfer

Step 2: This transaction, along with other transactions, are broadcast on the distributed global blockchain network

Step 3: During every interval (different depending on protocol), specialized computers called miners, collect transactions and combine them into a block

Step 4: Miners process the block. Once validated, the block of transactions is then added to the blockchain

Step 5: Miners are rewarded for securing the network and processing network transactions with newly minted coins

Step 6: Miners transmit the new block to the entire network, updating the ledger of transactions

Step 7: Transaction successfully mined and verified. Parties can view the transaction on the blockchain ledger

How are crypto assets controlled?

Wallets: software from each crypto system that enables control of transfers of assets, include public and private key pair.

- Custodial providers (Bitgo, Xapo)
- Self custodied: private keys/seed phrases
- Hardware wallets
- Externalized private keys
- “Brainwallets”
- Seed phrase backups
- Multisig: (“m of n” keys)
- Exchanges (a bad idea, but common)
- Anyone who has the private keys can control value held by that wallet.
- Don’t need initial instance of software

What's a Blockchain?

Blockchain: Tracking transactions of abstracted assets

(a/k/a DLT, private blockchain, permissioned ledger)

- Bitcoin, but without the bitcoins
- Use the model to track other data
- Different verification/control mechanisms
- Benefits:
  - Decentralization/coordination of data
  - Transparency/Auditability
  - Transaction speed

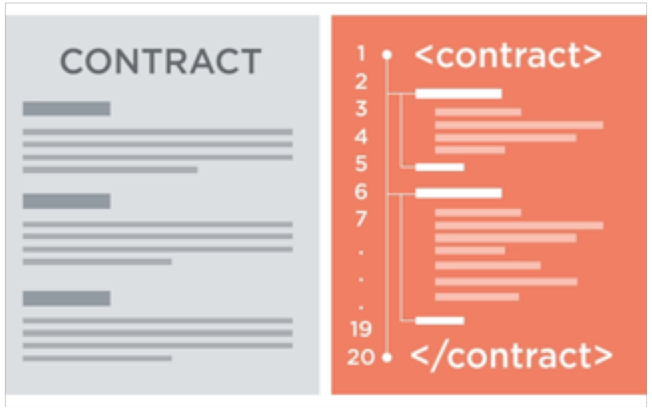
What is a token?

Tokenization of assets

- Ethereum allows code to trigger transactions
- Ethereum uses a blockchain to hold its assets and “Smart Contracts” made of executable code
- ERC 20- standard made creating new tokens easy
- One really simple idea has gained significant traction:
  - Bob declares he is raising capital for his Burgers: via an Ethereum ERC-20 Token Contract
  - Alice sends eth to Bob’s Contract
  - Bob’s Contract records Alice as a “token holder” and sends her Bob Tokens
  - Alice sells her Bob Token on the Charlie Exchange
- With Ethereum, YOU are your own CUSTODIAN and CODE CAN WORK LIKE A LEGAL CONTRACT

Are Smart Contracts Actually “Contracts”?

- Defining a Smart Contract
  - Nick Szabo: from M&Ms to Auto Starter Interrupters
  - Oracles, dispute resolution, and other systemic problems
- Does my smart contract create a legally enforceable agreement?
- How can parties to a smart contract avoid unintended consequences?
- When should you use these?
  - Regulatory Arbitrage
  - Routine transactions of value
  - Middleware/automation



Blockchain isn’t only for Bitcoin

Banking/Financial

Cybersecurity

Travel

Medical/Healthcare

Blockchain

Any industry can benefit from a decentralized ledger that is transparent, safe, auditable and resistant to outages

Charity

Legal

Music/Media

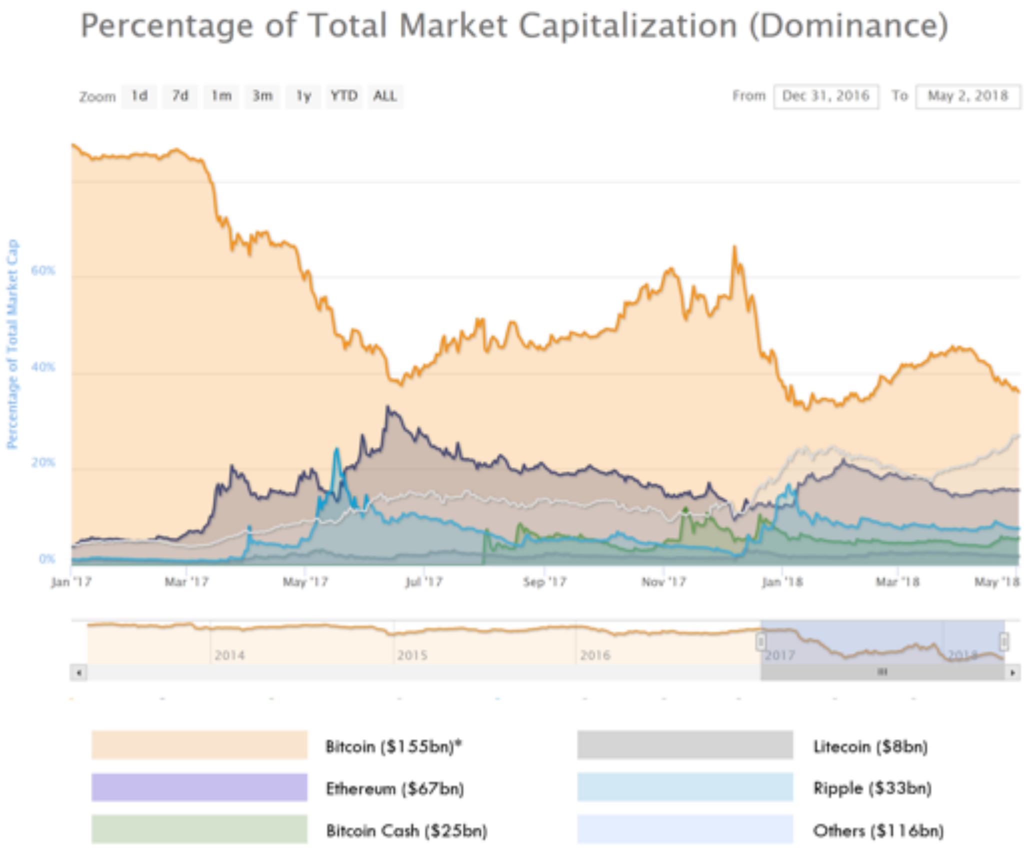
Energy

Insurance

Cloud Storage

Crypto assets are transforming the financing landscape

- In 2018, total market cap for crypto assets (cryptocurrency, tokens, etc.) reached $829 billion[1]
- Between 2014-2018, over $20 Billion raised in ICOs by token sale



Source: Coin Market Cap.
1. As of May 2, 2018. Total market capitalization peaked on January 8, 2018.

US Law Regarding Token Sales

- Usually considered investment contracts based on *Howey Test*:
  - Investment of money
  - Expectation of profit
  - Common enterprise
  - From efforts of promoter or 3rd party
- But not always securities
  - Utility Token concept not totally dead
  - Prepay for service
  - Currency (not usually pre-sold)
- Varying international approaches- utilities exist in Switz/UK/Singa
- If securities in the US, then
  - Exemptions (Reg D 506(c), Reg D, Reg CF, Reg A+)
  - "Saft" pre- offering model
  - Congressional bills seek to exempt/suspend penalties for "utility tokens"?

US Law is Still Developing

- Significant unaddressed legal issues :
  - Utility tokens
  - Custody of digital assets
  - Fiduciary duties of custodians
  - Secondary token trading
  - “Morphing” tokens
- States are experimenting with various approaches
  - NY Bitlicense
  - Wyoming “crypto friendly” laws
  - Del/WY/CA tokenized securities frameworks

How is Cryptocurrency taxed?

- IRS Notice 2014-21: Mar. 25, 2014
  Decentralized Virtual Currencies are considered property, not currency.
  - Payment received in DVC is gross income to recipient (like cash), but recipient must value the DVC (like property).
  - No foreign exchange gain or loss
  - However obtained, fair market value = tax basis of the asset.
  - **<u>Fair Market Valuation guidance is insufficient</u>**
  - Payor recognizes gains or losses (capital gain rates) for trading crypto for crypto like barter, report on Form 8949.
  - If paid as wages/self employment, subject to withholding for any employment tax, and information reporting as required for any other payment in property.
  - FMV of Tokens derived from mining is taxable income.
  - Backup withholding may be required for payments exceeding $600
  - No *de minimis* exemptions for transactions

Fair Market Value

- IRS Revenue Ruling 59-60, s. 2.02 (similar for gift tax: s. 25.2512-1)
  - Fair Market Value: …the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

Fair Market Value for cryptocurrency

- IRS Guidance 2014-21, at Q&A-5

A-5: For U.S. tax purposes, transactions using virtual currency must be reported in U.S. dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another real currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.

Market Manipulation:

By JONATHAN BERR / MONEYWATCH / *January 18, 2018, 5:56 AM*

Cryptocurrencies: Market manipulation a rising fear

COMMERCE GUEST

How bots are manipulating cryptocurrency prices

TIMOTHY TAM, COINFI DECEMBER 14, 2017 3:10 PM

Crypto Whales and How they Manipulate the price

endpoint (39) in cryptocurrency • 6 months ago

When you see a huge drop in a coins price, people will sometimes blame it on whales that are dumping on the market. Whales are people or possibly a group of people working together to hold a large percentage of that coin and can use this to their advantage to manipulate the price of a coin to the desired price. Typically when this occurs "weak hands" will start panic selling so they can buy back into the coin at a cheaper price. Not always does his tacit work in the whales favor.

- Crypto markets are not "Exchanges"
- Markets are heavily manipulated
- Market prices vary significantly
- Markets do not reflect actual trading activity
- Guidance, not law, not yet.

Fair Market Value

- The cost or selling price is a good indication of the property's value if:
  - The purchase or sale took place close to the valuation date in an open market,
  - The purchase or sale was at "arm's-length,"
  - The buyer and seller knew all relevant facts,
  - The buyer and seller did not have to act, and
  - The market did not change between the date of purchase or sale and the valuation date.

Fast Forward: Treasury vs. IRS

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

September 21, 2016

Reference Number: 2016-30-083

Where the IRS failed:

- Failed to develop a strategy for enforcement
- Failed to educate public & provide useful guidance
- Failed to simplify reporting
- Inspector General directed IRS to address these issues.

- What did the Service do?

The IRS responds…:

- In Re: John Doe Summons (California Northern District Court, Case No. 3:16-cv-06658-JSC)
  - For all US users of Coinbase between 2013-2015:
  - All customer data, KYC data, transaction records, payment records (& PKs!)
- Extensive litigation leads to a negotiated outcome
  - Limited to transactions >$20,000 USD.
  - Limited set of data to be produced
  - Result: 14,356 users’ data to be produced
- Result:
  - More taxpayers disclosing gains and losses
  - Frustrated CPAs
  - Pre- tax day sell offs

What about the Treasury report?

- No new simplified reporting
- No new guidance
- No new enforcement
- Why?
  - Executive priorities
  - 2018 Tax Bill
  - Overextension of IRS investigators

Example transaction:

- 1 BTC (in a vacuum)

  -No context/transactional data provided

  -IRS Guidance 2014-21 A-5: FMV based on available market data from exchanges

  -Select exchange or exchanges that are appropriate based on facts and circumstances of the trade

Example transaction:

- 1 BTC mined on January 1, 2018 at 1pm Est.
  - If the miner operates mining equipment as their occupation, the BTC is taxable gross ordinary income
  - An individual is likely taxable on such mined virtual currency (after deductions) at ordinary income tax rates (maximum 37%) and potential self-employment taxes (15.3%) if considered in the trade or business of mining. If the miner has another job, value the BTC at FMV
  - If a “hobby”, no tax due, but no mining losses applicable
  - Later sale may generate capital gains, basis = FMV at time of mining

Example transaction:

- $10,000 USD paid for 1 BTC on January 1, 2018 at 1pm Eastern Time
  - Is it “arms length”?
  - From where was it purchased? From whom?
  - Was it purchased via exchange?
  - Was any party under duress?

Example transaction

- .1 BTC traded for 2 ETH on 1/2/18 at 12:10am Est.
  - Treated like a sale of the .1 BTC and a purchase of the 2 ETH with the proceeds of the .1 BTC Sale
  - FMV Value of BTC at time of transfer becomes tax basis for 2 ETH acquired
  - (tax basis of the existing .1BTC)- (FMV of the .1BTC at the date of sale)= taxable gain or loss.

Example transaction

- Investor purchases $30,000 worth of BTC on 1/1/19
- Investor holds through 1/20/20
- When both presidential candidates argue for additional crypto regulation at a debate on 1/21/20 bitcoin price plummets
- Investor sells BTC for $20,000
  - Investor realizes a $10,000 short-term capital loss.
  - Assume no offsetting capital gains.
  - Investor is permitted to deduct $3,000 of the loss to offset his ordinary income.
- Investor must carry forward the rest of his capital loss ($7,000) that can be used to offset future capital gains or again claim the $3,000 ordinary loss for the next few years.

Current FMV concept is a failure

- Guidance is “stuck in 2014”
- Insufficiently vague
- Fertile ground for abuse/manipulation
- Lack of experienced/qualified valuation professionals
- Tools available do not comply
- Inconsistent results
- Complicates audits

Fixing Valuation

- Use actual buy/sell pairing data unless materially deviates from "market" value
- Use rules for "cross-listed" securities: records of exchange where asset or asset pair is "principally dealt in" should be used.
- Require exchanges to issue 1099-B/1099-MISC
  - Geography
  - Decentralized
- Provide more specific guidance
- Litigate
- Legislate

Valuation is a critical issue

- Charitable gifting
- Valuing illiquid assets/SAFTs
- Private equity funds
- Qualified appraisal required for +$5k charitable gift intervivos transfer, estate tax return
- Who can give these?

There probably aren't qualified valuators for crypto

IRC Section 170(f)(11) (amended by the Pension Protection Act) and the estate tax regulations (§20.2053) say…

- A Qualified Appraisal is…
  - Conducted by a qualified appraiser in accordance with generally accepted appraisal standards (e.g., see USPAP or ASA Business Valuation Standards).
  - Qualified Appraiser means an individual who
    - Has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations…
    - Regularly performs appraisals for which the individual receives compensation
    - **Demonstrates verifiable education and experience in valuing the type of property subject to the appraisal**
    - Has not been prohibited from practicing before the Internal Revenue Service by the Secretary under §330(c) of Title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal
- Similar requirement for gift tax appraisal

AICPA Asks the Hard Questions

<u>AICPA June 30, 2016 Letter:</u>

- 1031?
- *De minimis* use exception?
- OK for Retirement plans?
- When is crypto held by a merchant a “capital” good?
- LIFO/FIFO/Moving Average?
- Back out costs to obtain DVC from basis?
- Do charitable contributions under $5k USD require appraisal?
- Foreign reporting?

Does Section 1031 apply?

- Defers gain/loss for “like kind” transaction
- Held in use for trade or for investment
- Requires exchange of “like kind” goods
  - typically real estate for real estate
  - expressly excludes securities, bonds, debt
  - *See* IRS Pub 544- classes of qualified assets
- Report on Form 8824

LIFO/FIFO/Moving average?

- Which bitcoins are “sold” in a transaction?
- Directly impacts valuation
- Should wallet software govern? Or should wallet software providers adapt to regulation?
- Do taxpayers need to determine which UTXO was used in any given transaction?
- Does it matter if rule is divorced from reality?
- “Stateful” systems

US Tax Resident: International Information Reporting

- Most relevant foreign income reporting obligations:
  - FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* ("FBAR").
    - Required to report a financial interest in, or signature authority, over foreign financial accounts with an aggregate balance of $10,000 or greater at anytime during the calendar year.
    - Potential penalty of approximately $13,000 for non-willful failure to report or significantly higher for a willful failure to report.
  - Form 8938, *Statement of Specified Foreign Financial Assets*.
    - US tax resident that holds either: 1) more than $75,000 of foreign financial assets at any time during the year; or 2) more than $50,000 of foreign financial assets as of December 31st.
    - Failure to file penalty of $10,000 or $50,000 for continual failure.

Can cryptoassets be “foreign”?

- Where is a cryptoasset “located”?
  - Key holder
  - Every location of private key
  - Where any node is operated
  - Exchange location of operation/server
  - Exchange location of incorporation
- Is leaving an asset on an exchange a bailment? If so, does legal location change?

AICPA revisited

<u>AICPA May 30, 2018 Suggests :</u>

- Mining expenses be offset against value obtained
- *Unhelpful clarification of fair market value*
- Allow taxpayer to pick LIFO/FIFO/Moving average
- $200 *de minimis* election
- Not require qualified appraiser for charitable contribution of crypto
- Airdrops/fork – zero basis assets, taxpayer files Election to include airdrop/fork as ordinary income
- Token swaps= not a taxable event
- Staking income ordinary income
- Treat traders like securities brokers- mark to market rules
- OK to hold in IRAs

Tax Considerations: ICOs/Securities

- ICO’s aren’t generally securities offerings:
  - In a stock initial public offering, a corporation does not recognize gain or loss. *See* IRC 1032.
  - Accepting cash or property for investments in a newly started fund (“partnership”) is largely a tax neutral event (unless determined to be a disguised sale).
  - The issuance of a new cryptocurrency/token (except <u>perhaps</u> an equity token that issues voting rights or profit interests) - probably a taxable event.
- Potential Tax Consequences to Issuer of non-security tokens:
  - Viewed as a sale of property: Ordinary income based on FMV paid by investors.
  - For a corporation- 21% tax (assuming no other expenses plus tax to shareholders on dividends)
  - For a partnership: 37% tax to the partners (assuming no other expenses).
- Potential Tax Consequences to Investor
  - If paying cash, then the initial investment would likely not be a taxable event.
  - If paying with other cryptocurrency, then the investment itself may be taxable.
  - Future contract/Simple Agreement for Future Tokens (“SAFT”)?
- <u>NO FORMAL GUIDANCE AVAILABLE.</u>

State Tax Approaches

- Michigan, Missouri, Wisconsin: Virtual Currency is not taxable service or tangible property subject to state sales tax.
  - But: Michigan 2015 guidance taxpayer accepting virtual currency in a retail sale transaction must convert the value of the virtual currency to USD as of the day and the exact time of the transaction and remit appropriate sales and use tax.
- Alabama, Massachusetts, & New Jersey require “marketplace facilitators” (issuers of virtual currencies used as payment instruments) to collect sales tax
- Arizona: Pending bill would add income "derived from the exchange of virtual currency for other currency" to the computation of Arizona adjusted gross income for the purposes of state income tax. S.B. 1145, 53d Leg., 2nd Reg. Sess. (Ariz. 2018).

State Tax Approaches, cont.

- Nevada banned local governments from taxing “blockchain” use.
- New Jersey has issued guidance that it would conform to the federal tax treatment of virtual currency, meaning that virtual currency would be treated as intangible property and subject to sales tax. See Technical Advisory Memorandum, N.J. Division of Taxation, Convertible Virtual Currency (TAM–2015–1(R)) (July 28, 2015).
- In 2015, Utah proposed a bill, which failed, that would allow residents to pay taxes with virtual currencies. H.C.R. 6, 2015 Leg., Gen. Sess. (Utah 2015).
- Wyoming exempts virtual currency from state property taxes. S.F. 111, 2018 Budget Sess. (Wyo. 2018).

What about enforcement?

- Joint Chiefs of Global Tax Enforcement (aka the J5): Taxing authorities of US, UK, AUS, & Netherlands, Australian CIA
  - Expressly created to identify cross border tax fraud
  - Expressly includes cryptocurrencies as an area of international tax criminal risk
- "The formation of the J5 demonstrates the serious commitment of governments around the globe in enhancing international cooperation in fighting serious international tax and financial crimes, money laundering, and <u>cybercrime through the use of cryptocurrencies</u>."
- IRS caught $9.7 billion in tax fraud, $10.4 billion in other financial crimes in 2018 (up from 2017: $2.5/$1.1 Billion)
  - Leveraging big data analytics
  - Expect this trend to continue

Pay your taxes with Crypto?

- State of Ohio will let businesses pay tax debts with bitcoin:
  - Payment via processor Bitpay- <1% fees
  - Paying taxes is not taxable-
  - BUT: paying with property may lead to a taxable gain or loss.
- Seminole County, Fla. Tax Appraiser- May 2018
  - Collects for IDs, License plates, Property Taxes
  - also via Bitpay
- What's the benefit to paying taxes in crypto?
- <u>Modern Monetary Theory</u>: Taxation & issuance of legal tender enable power to discharge debt and establish the fiat money as currency, giving it value by creating demand for it in the form of a private tax obligation that must be met.
- Does this legitimate crypto in a meaningful way?

Unaddressed Tax Questions:

- Forks
- Airdrops
- LIFO/FIFO/Moving average
- Do charitable contributions exceeding $5k USD require a “qualified appraisal?”
- Token Issuers:
  - ICO Reserved tokens- capital assets?
  - Sold tokens- Goods sold, equity, or debt?
- Tokenized Securities
- “Lost” keys
- Cryptoassets in a multisig wallet
- Cryptoassets in an unexecuted smart contract

Estate Planning Opportunities:

- How exactly do you pass these assets down?
- How do you protect a private key that controls high value bearer assets?
- How do you structure a plan to minimize tax burden?

(R) UFADAA

- Revised Uniform Fiduciary Access to Digital Assets Act: Now enacted or pending in most states
- User may designate someone to take custody of digital assets from custodian of online assets
    1. Provides for legally enforceable directions for disposition of digital assets by will, trust, or power of attorney (or by guardianship/probate order)
    2. BUT- Crypto assets are not usually held by an identifiable custodian
        1. May be helpful if assets held on a custodial exchange
        2. Otherwise, need to figure out an effective way to convey a private key/seed phrase

Teach your children (or fiduciaries) well…

- Beneficiaries /fiduciaries should be familiar with crypto assets
- Need to recognize terminology and recognize cryptoassets when/if they find records
- If family members can't find assets, can't realize them
- Hire a consultant
- **Lost private keys = irrevocably lost value**

Where to find evidence of crypto asset use

- Computer web browser history-
  - Web site bookmarks/cookies related to crypto, bitcoin, blockchain, crypto exchanges.
  - Look for plugins: Metamask, KeepKey.
  - Software wallets- Edge, Xapo, BRD
- Email account- emails from exchanges/trading platforms/trading partners
- Bank records- look for transfers into or out from trading platforms, purchases of equipment, “swag”
- Cold storage devices (plug-in peripherals used to store private keys; usually connect via USB)
  - Examples: KeepKey, Trezor, OpenDime, Ledger
- Dedicated “air-gapped” computers
- Mobile devices- tables, smart phones- look for apps, browsing history
- Safe deposit boxes- look for writings including random strings of numbers/letters

How to Access Crypto Assets

Fiduciary needs to know how to access assets.

1. Physical access to device (computer, application, peripheral)
2. Password for access, or private key to reset/access on new device
3. Transfer assets back to an exchange to liquidate or convert
4. Or transfer to a beneficiary’s wallet address
5. May want to seek professional assistance
6. ***<u>Practice!</u>***

Old School Strategy: Write it Down on Paper.

- The more complicated the storage systems, the more likely something will be lost, broken, or go wrong.
- Organization, storage of devices, and storage of paper.
- Allows recovery of assets even if a “hot” wallet can’t be located
- Must have trusted storage location, trusted parties to access data
- Must be updated regularly

Old School Plan – Key Elements

- List of assets (Name /symbol; not quantities, not USD eqiv. values)
  - E.g., BTC (bitcoin); ETH (Ethereum); LTC (Litecoin)
- List of physical devices used to access them
- List of applications on those devices
- List of exchanges used
- List of software used
- Method of access (keep private keys separate from devices)

Device access table

Device/Software	PIN	Password	Backup #1	Backup #2
Smartphone Wallet	9999	Password Manager	Safe #1	Safe #2
Hardware Wallet	999999	None	Safe #1	Safe #2
Exchange Acct	One Time Password (Google)	Password Manager	None	None
Paper Wallet	None	None	Safe #1	Safe #2
Mnemonic (Seed)	None	Password Manager	Safe #1	Safe #2
Physical Coin	None	None	Safe #1	None

Never list private keys
in estate planning documents

NEVER.

Never write down private keys in
any situation where anyone else can read them
without express authorization.

Provide a narrative to guide your fiduciaries

- List providers/services used
- List devices used and their physical locations
- List any trusted persons for fiduciaries to contact for technical assistance
- List locations of safes/deposit boxes that hold keys in written form
- May separate keys/external devices in different locations
- Balance disclosure/protection

Planning Structures Illustrated:

- Slides adapted from materials created by Matthew T. McClintock, JD, TEP
- Details a few structures suggested to accomplish various goals- anonymity, tax free exchange, free up assets for reinvestment, etc…

Planning Case Study #1

- Mom (mid-60s) inherits 100,000 tokens from son in 2016
- Doesn't really "get" crypto; wants to liquidate most & buy real estate
- Currently keeping tokens on centralized exchange
- (Assume below are FMV)
  - 2016 value = $7 USD/token
  - 2018 value = $30 USD/token

$3,000,000 value

Mom's gain = $2,640,000

- Federal CG rate = 20%

($460,000 federal CG tax)

Objectives

- Secure crypto off exchange
- Liquidate in tax-efficient structure
- Reinvest in tax-efficient & protected structure
- Control sale of crypto & acquisition of replacement property

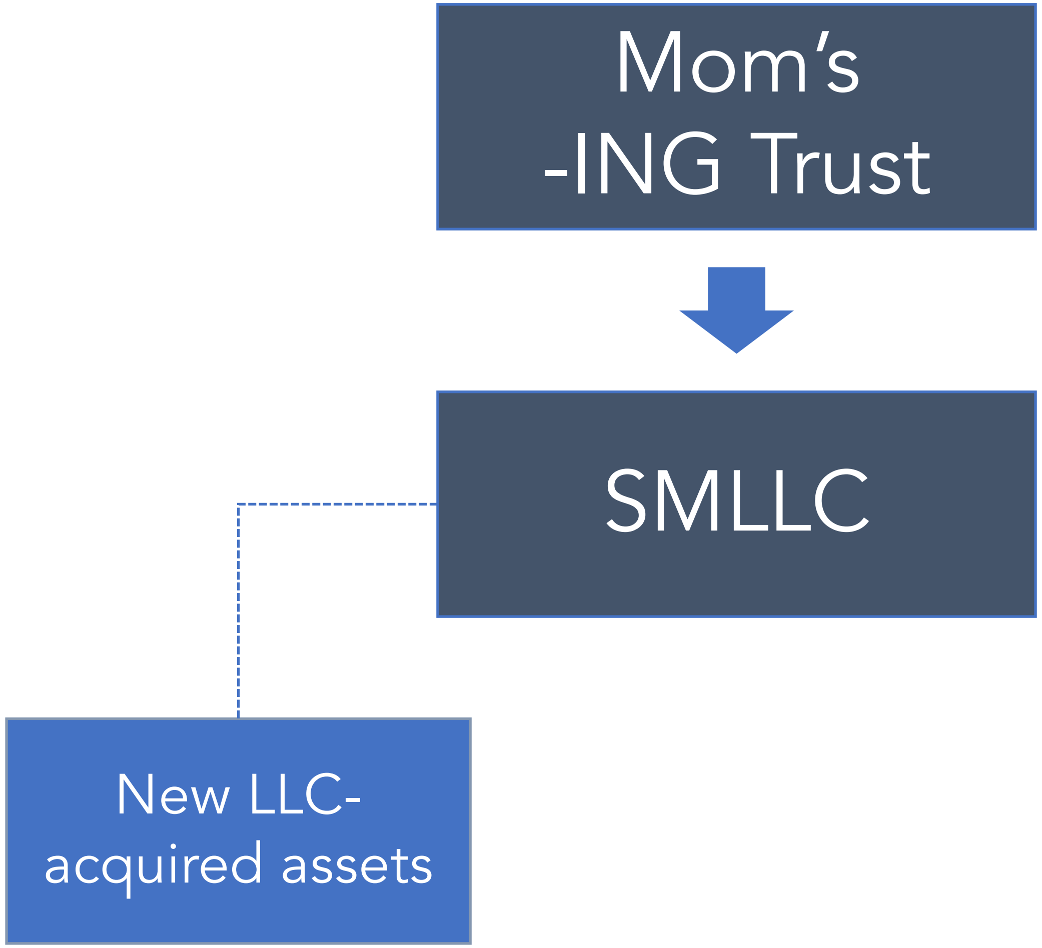
Strategies

- Assist with private asset custody
- Heavily customized “-ING” trust to situs assets in new state
- Customized LLC in highly protective jurisdiction
- Customized Investment Policy Statement for LLC
- Establish multi-signature wallet to facilitate sales through legal structure

Outcomes

- Confidence in directly managing cryptoassets
- Cryptoasset succession plan in place
- Crypto sales occur in zero-tax (state) environment
- Proceeds reinvested privately in protected LLC/trust combination
- Trust design integrates with revocable trust plan

"-ING" spendthrift trust



Trust features:

- Incomplete gift
  (estate inclusion not an issue)
- Irrevocable QST
- Client is trust investment advisor
- Corporate trustee for situs

Key steps:

- LLC manager opens bank account (with corporate trustee)
- Create multi-sig wallet & link to account
- Client transfers crypto to wallet
- Client (investment advisor) may initiate sale/trade
- Other signatures in wallet prompted to finalize
- Proceeds reinvested in LLC
- Sale escapes state LTCG
  (~ $100k on every $1MM sale)

Matthew T. McClintock, JD, TEP
Evergreen Legacy Planning, LLP

Case Study #2

- Married couple, one child. Residents of separate property state with income tax
- $20MM crypto holdings (highly appreciated; mixed basis)
  - Approximately $19,000,000 of unrealized CG
  - Began acquiring <$30 USD/token
- Misc. real property, business interests, cash = $150MM
- Very crypto-savvy
- Zero debt
- Total estate = $170,000,000

Objectives

- Protect surviving wife, child
  (remarriage protection; inheritance preservation)
- Efficiently diversify BTC holdings
- Increase privacy (goal = anonymity)
- Dramatically increase protection
- Tax reduction

Domestic Strategies

- Multiple DAPT“-ING” trusts to escape home state income tax on sales
  - CRT as permissible beneficiary
- Customized LLC in highly protective, private jurisdiction
- Unrelated non-member LLC manager for new acquisitions
- Customized Investment Policy Statement for LLC
- Multi-signature wallet to facilitate sales
- Elective community property trust for longer-term BTC, equity holds

Offshore Strategies

- Completed gifts to leverage $22MM combined exemptions
  - Future growth outside gross estate
- Offshore APT holding multiple offshore highly customized LLCs
- Offshore trust protector

Outcomes

- Crypto sales occur in zero-tax (state) environment
  - Eliminates up to $2,500,000 state CG tax
  - CRT defers approx. $4,000,000 federal CG tax up to 20 years
- Proceeds reinvested <u>anonymously</u> in protected LLC/trust combination
- Trust design integrates with revocable trust plan

"-ING" spendthrift trusts

Husband Trust

H/W/C benes

Wife Trust

W/C benes;
(H by POA)

MMLLC

Bespoke Protector Co. LLC (WY)

Unrelated nonmember manager

Trust features:

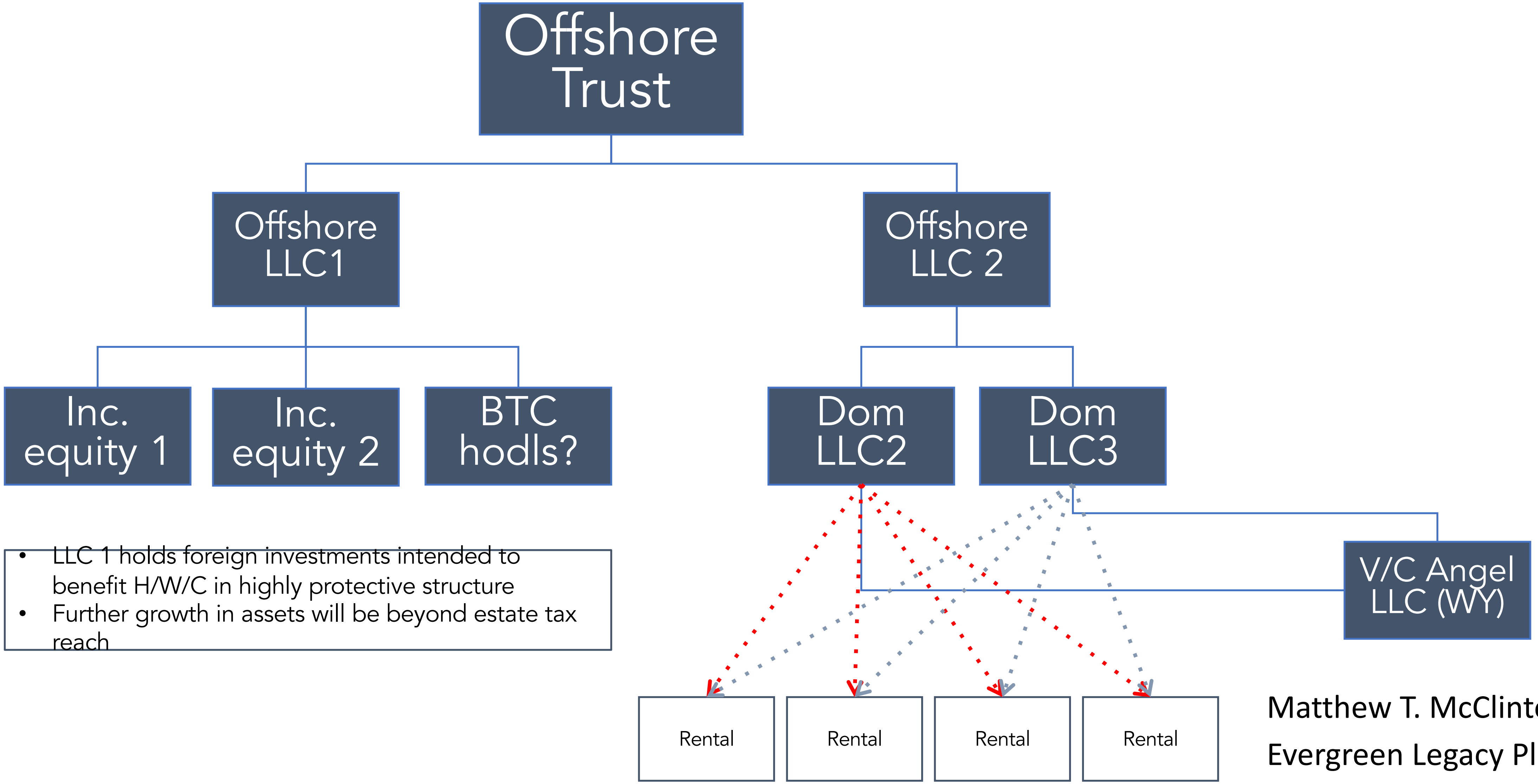
- Incomplete gift
  (estate inclusion not an issue)
- Irrevocable QST
- Client is trust investment advisor
- Corporate trustee for situs
- Unrelated individual trust protector
- Distribution committee

Key steps:

- LLC manager opens bank account (with corporate trustee)
- Register with OTC crypto liquidator
- Create multi-sig wallet & link to account
- Client transfers crypto to wallet
- Client (investment advisor) may initiate sale/trade
- Other signatures in wallet prompted to finalize
- Proceeds reinvested in LLC per investment statement
- Client's name appears nowhere in public records
- Sale escapes state state LTCG

Matthew T. McClintock, JD, TEP
Evergreen Legacy Planning, LLP

Step 2: Advanced Offshore Strategies



- LLC 1 holds foreign investments intended to benefit H/W/C in highly protective structure
- Further growth in assets will be beyond estate tax reach

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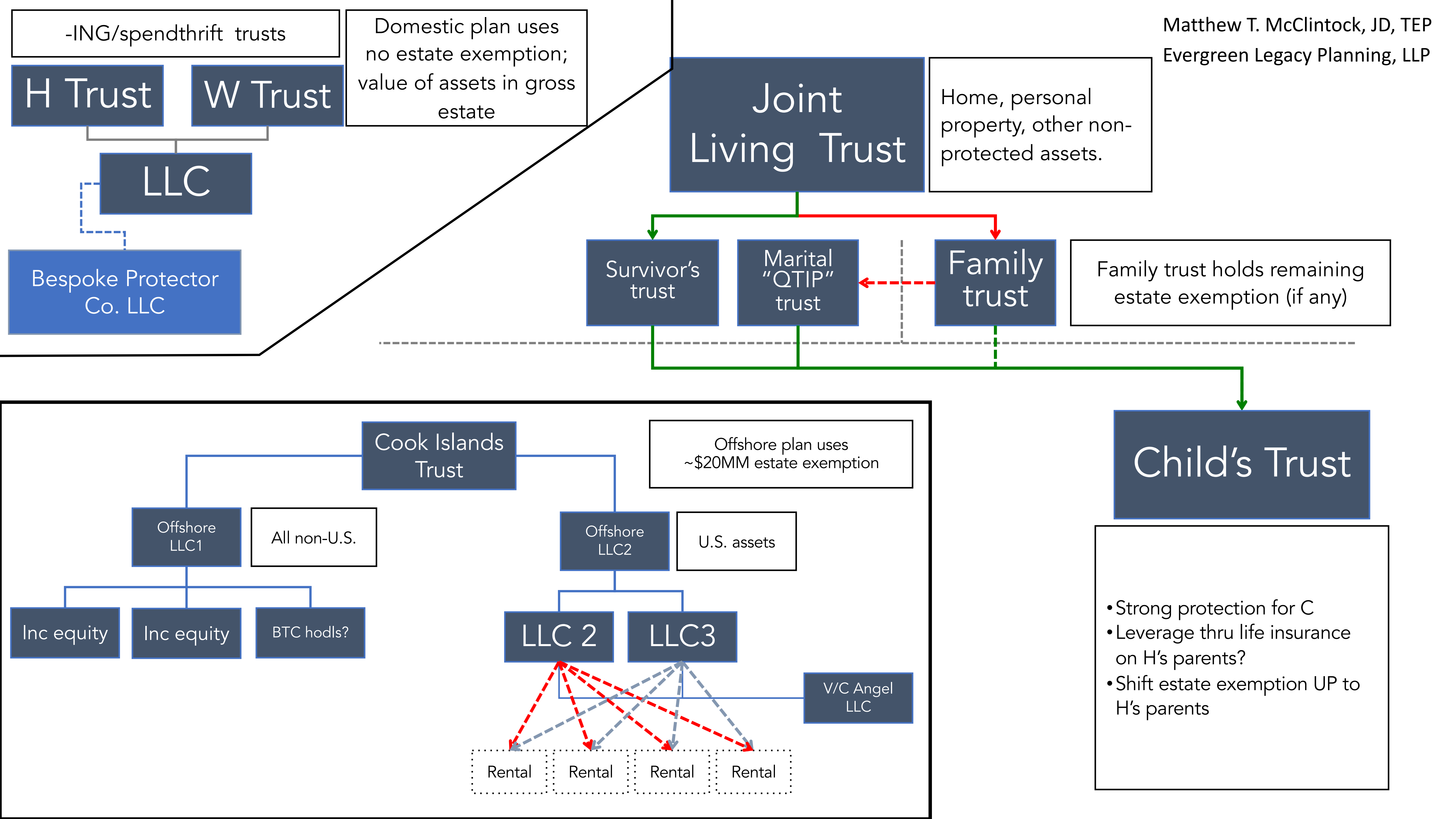
Tying it all together



-ING/spendthrift trusts
H Trust
W Trust
Domestic plan uses no estate exemption; value of assets in gross estate
LLC
Bespoke Protector Co. LLC
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Joint Living Trust
Home, personal property, other non-protected assets.
Survivor's trust
Marital "QTIP" trust
Family trust
Family trust holds remaining estate exemption (if any)
Cook Islands Trust
Offshore plan uses ~$20MM estate exemption
Offshore LLC1
All non-U.S.
Offshore LLC2
U.S. assets
Inc equity
Inc equity
BTC hodls?
LLC 2
LLC3
V/C Angel LLC
Rental
Rental
Rental
Rental
Child's Trust
•Strong protection for C
•Leverage thru life insurance on H's parents?
•Shift estate exemption UP to H's parents

Concluding Thoughts:

- Tax guidance needs substantial clarification/revision
  - Valuation
  - Classification of crypto assets among commodities/securities/property
  - Look at courts, not guidance
- Expect further enforcement by IRS
- Lost keys = lost value
  - Expect service providers, vendors to emerge to facilitate key recovery
- Crypto is a premiere tool for asset flight
- The law will continue to be dynamic
  - Congress is the next battleground.