

DECODING CRYPTOCURRENCY TAXES: THE CHALLENGES FOR ESTATE PLANNERS

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ABSTRACT

In this article, Angel explores the unique challenges of estate planning with cryptocurrency, which include accurately valuing those assets, preserving their value, and addressing the complex tax implications of transferring cryptocurrency to heirs.

INTRODUCTION

The rapid growth of cryptocurrencies has created a new group of millionaires and established virtual currencies as a significant form of investment.¹ Although there are still uncertainties regarding cryptocurrencies and virtual currencies in general, their popularity is increasing to the extent that the world may eventually transition toward some form of digital currency.² Cryptocurrencies can offer benefits in terms of preserving the wealth and security of individual estates.³ Estate planning with cryptocurrency assets, however, can be complex because the value of these assets can be highly volatile, and there may be a lack of clear guidance from governments and tax authorities.⁴ This has led to

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¹ Stephen Gandel, *There May Now Be as Many as 100,000 Bitcoin Millionaires*, CBS NEWS (Feb. 23, 2021, 3:57 PM), <https://www.cbsnews.com/news/bitcoin-millionaires-100k/>.

² David Rodeck, *Digital Currency: The Future of Your Money*, FORBES, (Feb. 16, 2023, 10:50 AM), <https://www.forbes.com/advisor/investing/cryptocurrency/digital-currency/>.

³ Mariah Paulger, *In The Crypt: The Importance of Planning for Distribution of Cryptocurrency Assets After Death*, 14 EST. PLAN. J. 621, 623–24 (2022) (“Specifically, crypto has a lot to offer in maintaining the wealth and security of individual estates, and estate planners need to be aware of crypto’s opportunities for helping plan and manage different estates.”).

⁴ *Id.* at 653; *see also* Karin C. Prangle & Suzanne Brown Walsh, *Understanding Cryptocurrency in Estate Planning*, AM. COLL. OF TR. AND EST. COUNS. (Sept. 8, 2022), <https://www.actec.org/resource-center/video/understanding-cryptocurrency-in-estate-planning/>.

discussions around the transfer of digital assets to heirs, taking into consideration tax and estate planning.

Because the IRS considers cryptocurrency to be property, it is subject to the same tax rules as other types of property.⁵ This means that there is a taxable event every time a crypto transaction occurs. Thus, when cryptocurrency is passed on to heirs as part of an estate, it may be subject to estate and income taxes.⁶ However, the complexities surrounding the value of these assets and the lack of clear guidance make estate planning for cryptocurrency assets a challenging task.⁷

This article provides an overview of the cryptocurrency tax regime and offers guidance to estate planners navigating this complex and rapidly evolving landscape. It also recommends that Congress and Treasury take action to establish a comprehensive and coordinated system for taxing cryptocurrency and blockchain activities to promote responsible use while also ensuring that these activities are subject to appropriate taxation. This report is limited to cryptocurrencies and does not address other digital assets such as initial coin offerings, central bank digital currencies, stable coins, or non-fungible tokens (NFTs).

I. DEFINING CRYPTOCURRENCY

A. Background and Origins

The 2008 financial crisis resulted in a widespread loss of confidence in traditional financial institutions and their ability to safeguard the public's interests.⁸ As a result, there was growing demand for a more secure and transparent financial transaction system.⁹ This, coupled with advances in technology, paved the way for the development of cryptocurrency and blockchain technology.

Bitcoin, the first and most well-known cryptocurrency, was created in 2009 by an anonymous person or group using the pseudonym "Satoshi Nakamoto."¹⁰ Bitcoin is based on a decentralized, peer-to-peer

⁵ I.R.S. Notice 2014-21, 2014-16 IRB 938.

⁶ *Id.*

⁷ FREEMAN L., *Estate Planning and Cryptocurrency*, <https://freemanlaw.com/estate-planning-and-cryptocurrency/> (last visited Mar. 11, 2024) (noting some issues for estate planners include ensuring that heirs can access and inherit a digital asset, the tax implications for the transfer of crypto assets, and ways to minimize gift and estate taxes when transferring digital assets).

⁸ Timothy C. Earle, *Trust, Confidence, and the 2008 Global Financial Crisis*, 29 RISK ANALYSIS J. 785, 795 (2009).

⁹ *Id.*

¹⁰ Adam Hayes, *Who Is Satoshi Nakamoto?*, INVESTOPEDIA (Mar. 11, 2024),

network and uses cryptography to secure transactions and control the creation of new units of currency.¹¹ The idea behind bitcoin and other blockchain technology was to create a digital currency that would operate independently of central banks and other traditional financial institutions, thereby providing an alternative to the existing financial system that would be more secure, transparent, and accessible to anyone with an internet connection.¹²

Bitcoin's success led to the development of numerous other cryptocurrencies, each with its own unique features and purposes.¹³ Today there are thousands of different cryptocurrencies in circulation, with a total market capitalization of more than \$1 trillion.¹⁴ Though bitcoin and other cryptocurrencies remain somewhat controversial and subject to regulation,¹⁵ they have also attracted significant interest from investors, businesses, and consumers around the world.

B. What is Cryptocurrency?

A digital asset is a digital representation of value that is recorded on a secured, distributed ledger.¹⁶ Cryptocurrency is a type of digital asset that is built on blockchain technology.¹⁷ A blockchain is a distributed ledger technology that is used to record and verify transactions.¹⁸ As a blockchain-based system, cryptocurrency is decentralized, meaning it is

<https://www.investopedia.com/terms/s/satoshi-nakamoto.asp>.

¹¹ Paulger, *supra* note 3, at 624.

¹² See Hilary J. Allen, *The Superficial Allure of Crypto*, IMF (Sept., 2022), <https://www.imf.org/en/Publications/fandd/issues/2022/09/Point-of-View-the-superficial-allure-of-crypto-Hilary-Allen> (“By distributing power and governance in the system, there is theoretically no need for trusted intermediaries like financial institutions.”).

¹³ Adam Hayes, *10 Important Cryptocurrencies Other Than Bitcoin*, INVESTOPEDIA (Feb. 20, 2024), <https://www.investopedia.com/tech/most-important-cryptocurrencies-other-than-bitcoin/> (noting examples of other cryptocurrencies, including ethereum, tether, and XRP).

¹⁴ CMC RSCH., *According to CMC: Crypto market Analysis H1 2023*, <https://coinmarketcap.com/academy/article/according-to-cmc-crypto-market-analysis-h1-2023> (last visited Mar. 11, 2024) (reporting the global crypto market cap as of Mar. 10, 2024, as \$1.17 trillion).

¹⁵ Indeed, cryptocurrency regulation is evolving globally and in the United States to address its impact and risks.

¹⁶ I.R.S. News Release IR-2023-12 (Jan. 24, 2023).

¹⁷ Amanda Parsons, *Cryptocurrency, Legibility, and Taxation*, 72 DUKE L.J. 1, 3 (2022) (“Cryptocurrency is a digital representation of value that is based on blockchain technology.”).

¹⁸ *Id.* at 3–4.

not controlled by any central authority such as a government or bank.¹⁹ In a traditional banking system, transactions are verified and processed by a central authority, such as a bank, which maintains a centralized ledger of all transactions.²⁰ However, in a blockchain-based system, transactions are recorded on a distributed ledger, which is accessible to all participants on the network.²¹ This means that each transaction can be independently verified by multiple parties on the network, rather than relying on a single central authority.²² By using cryptography and complex algorithms to ensure the accuracy and security of the ledger, blockchain technology enables trustless and decentralized transactions that are resistant to fraud, tampering, and censorship.²³

C. Adding to the Blockchain

The creation of new units of cryptocurrency can occur through various processes, including mining and staking. Both mining and staking are critical components of the consensus mechanism that confirms transactions and maintains the integrity of the distributed ledger. Notably, to ensure that each unit of cryptocurrency retains value, many cryptocurrencies have a hard cap on the total number of units that can ever be created.²⁴

¹⁹ Paulger, *supra* note 3, at 624 (“The purpose behind having a ‘peer-to-peer’ system is to ‘decentralize’ transactions as opposed to having a central authority (e.g., a bank) that monitors and facilitates transactions.”); *see also* Allen, *supra* note 12 (“By distributing power and governance in the system, there is theoretically no need for trusted intermediaries like financial institutions.”).

²⁰ COINMARKETCAP, *Central Ledger*, <https://coinmarketcap.com/academy/glossary/central-ledger> (last visited Mar. 11, 2024) (“Central ledgers are physical books or digital files used by individuals or organizations to record and total economic transactions in a centralized manner.”).

²¹ Adam Hayes, *Blockchain Facts: What Is It, How It Works, and How It Can Be Used*, INVESTOPEDIA (Dec. 15, 2023), <https://www.investopedia.com/terms/b/blockchain.asp> (“A blockchain is a distributed database or ledger that is shared among the nodes of a computer network.”).

²² *Id.* (“Once a transaction is recorded, its authenticity must be verified by the blockchain network.”).

²³ Parsons, *supra* note 17, at 4–5.

²⁴ COUNCIL OF ECON. ADVISERS, ECONOMIC REPORT OF THE PRESIDENT 243 (2023) (“The supply of bitcoins is capped to ensure that each unit retains value, since digital assets otherwise could be reproduced perfectly forever, and they would have no value if there were an unlimited supply.”); *see also* Adam Hayes, *What Happens to Bitcoin After All 21 Million Are Mined?*, INVESTOPEDIA Dec. 18, 2023), <https://www.investopedia.com/tech/what-happens-bitcoin-after-21-million-mined/#:~:text=What%20Happens%20After%20All%2021,new%20bitcoins%20will%20be%20issued.&text=The%20offers%20that%20appear%20in,from%20which%20Investopedia%20receives%20compensation> (noting that the limit on

Mining, also referred to as “proof of work,” involves the use of powerful computers to solve complex mathematical equations that verify transactions and add new blocks to the blockchain.²⁵ Similarly, staking, also referred to as “proof of stake,” involves users holding a certain amount of cryptocurrency in a designated wallet and participating in the validation of transactions based on the amount held.²⁶ Individuals who participate in mining or staking are rewarded with newly minted cryptocurrency as an incentive for their participation in the validation process.²⁷

D. Wallets

Cryptocurrency wallets are commonly used to safely store digital assets. A cryptocurrency wallet is a software program that interacts with various blockchains to enable users to send and receive digital currency and monitor their balance.²⁸ Hot and cold wallets refer to two types of storage options for cryptocurrencies.²⁹ For estate tax purposes, there is no advantage to selecting one wallet over the other so long as the assets are secure and the estate has access to the wallet after the decedent’s death.

A hot wallet is a software-based cryptocurrency wallet that is connected to the internet and can be accessed through a web browser or mobile application.³⁰ Examples of hot wallets include exchange wallets, desktop wallets, and mobile wallets.³¹ Hot wallets are often used for frequent transactions because they provide quick and easy access to the cryptocurrency.³² Because they are connected to the internet, however, they can be more vulnerable to hacking attacks and other security breaches.³³

the amount of bitcoin that can ever be mined is 21 million coins).

²⁵ Parsons, *supra* note 17, at 5.

²⁶ Paulger, *supra* note 3, at 628.

²⁷ *Id.*

²⁸ *Id.* at 628-29.

²⁹ *Id.*

³⁰ *Id.* at 629.

³¹ THE INVESTOPEDIA TEAM, *Hot Wallet: Definition, Types, Examples, and Safety Tips*, INVESTOPEDIA (May 30, 2023), <https://www.investopedia.com/terms/h/hot-wallet.asp#:~:text=Examples%20of%20hot%20wallets%20are,all%20of%20your%20digital%20assets> (“Examples of hot wallets are MetaMask, Coinbase Wallet, and Edge Wallet.”).

³² Paul Sokolov, *Crypto Wallets: Hot vs. Cold Wallets*, GUARDA (May 2, 2022), <https://guarda.com/academy/security/crypto-wallets-hot-vs-cold/> (“Hot wallets are software-based wallets connected to the internet and provide easy accessibility to your funds, making them convenient for frequent transactions.”).

³³ Paulger, *supra* note 3, at 629 (“A hot wallet has the potential to be hacked

A cold wallet, on the other hand, is a hardware-based cryptocurrency wallet that is not connected to the internet.³⁴ Cold wallets store the private keys needed to access the cryptocurrency offline, making them less susceptible to hacking attempts and other security threats.³⁵ They are often used for long-term storage of large amounts of cryptocurrency, such as for investment or savings purposes.³⁶ Examples of cold wallets include paper wallets, a document that has public and private keys written on it, and hardware wallets, like an external hard drive.³⁷

E. Keys

A cryptocurrency key refers to a complex string of characters that serves as a unique identifier for a specific cryptocurrency wallet.³⁸ The private key is a secret piece of data that is used to access the wallet and sign transactions, whereas the public key is a public-facing address that other users can send cryptocurrency to.³⁹ The private key is essentially a password, and whoever has access to it can spend the cryptocurrency stored in the associated wallet. Storing cryptocurrency in wallets is

because it exists online.”); *see also* THE INVESTOPEDIA TEAM, *supra* note 31 (“Because hot wallets are connected to the internet, they tend to be somewhat more vulnerable to hacks and theft than cold storage methods.”).

³⁴ Sokolov, *supra* note 32 (“Cold wallets or cold storage are physical devices that store and manage cryptocurrency offline.”).

³⁵ *Id.* (“Cold wallets are more secure than hot wallets, come in various forms, including USB drives and paper, and are often equipped with additional security features to protect your cryptocurrency.”).

³⁶ John Gilbert & John Lee Quigley, *What Are Cold Wallets? The Most Secure Crypto Custody*, BLOCKWORKS (Feb. 20, 2023), <https://blockworks.co/news/cold-wallets-secure-crypto-custody> (“The term ‘cold’ also implies that the stored assets remain untouched for a relatively long period . . . Think of them as a safety vault full of gold.”).

³⁷ Paulger, *supra* note 3, at 629; *see also* THE INVESTOPEDIA TEAM, *Cold Storage: What It Is, How It Works, Theft Protection*, INVESTOPEDIA (Dec. 3, 2023), <https://www.investopedia.com/terms/c/cold-storage.asp> (explaining how cold storage works).

³⁸ THE INVESTOPEDIA TEAM, *Private Key: What It Is, How It Works, Best Ways to Store*, INVESTOPEDIA (Feb. 17, 2023), <https://www.investopedia.com/terms/p/private-key.asp> (“Cryptocurrency is controlled through a set of digital keys and addresses, representing ownership and control of virtual tokens.”).

³⁹ *Id.* (“A private key is a long alphanumeric code that acts similarly to a password.”); *see also* THE INVESTOPEDIA TEAM, *Public Key: Meaning, Overview, Special Considerations*, INVESTOPEDIA (June 24, 2021), <https://www.investopedia.com/terms/p/public-key.asp> (“A public key is a cryptographic code used to facilitate transactions between parties, allowing users to receive cryptocurrencies in their accounts.”).

considered a secure method;⁴⁰ nevertheless, if the private key that manages the wallet is lost, the cryptocurrency transferred to the wallet cannot be retrieved and is lost permanently.⁴¹

II. CURRENT CRYPTOCURRENCY TAXATION REGIMES

Categorizing assets and income is fundamental to tax law to determine their tax treatment. As discussed below, however, cryptocurrencies pose a regulatory challenge since they do not fit neatly into the traditional asset categories used by tax law. As a result, determining the appropriate tax treatment for cryptocurrency can be complex and uncertain.

A. Classification of Cryptocurrency

The federal government has yet to provide a definitive classification of cryptocurrency as an asset class, leading to diverging views among various regulatory bodies. Although the SEC has identified certain cryptocurrencies as securities,⁴² the Commodity Futures Trading Commission considers them commodities,⁴³ and the IRS classifies them as property for tax purposes.⁴⁴ The lack of a unified approach to categorizing cryptocurrencies has created ambiguity and uncertainty for market participants, as well as for regulators and lawmakers who seek to develop effective policies to govern this fast-evolving sector.⁴⁵ The need for greater clarity and consistency in how cryptocurrencies are classified

⁴⁰ See *supra* Section II.D.

⁴¹ Shaina Kamen, *Don't Lose Your Wallet! Five Things To Know About Estate Planning With Cryptocurrency*, HOLLAND & KNIGHT (2022), <https://www.hklaw.com/en/insights/publications/2022/08/dont-lose-your-wallet> (“If the key is lost, there is no way to recover it to gain access.”).

⁴² SEC STRATEGIC HUB FOR INNOVATION AND FIN. TECH., *Framework for ‘Investment Contract’ Analysis of Digital Assets*, SEC (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (citing *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946)) (noting that if a cryptocurrency satisfies the *Howey* test to be classified as an investment contract, it would be considered a security and consequently subject to regulation by the SEC).

⁴³ CFTC, *Bitcoin Basics*, <https://www.cftc.gov/node/221826> (last visited Mar. 11, 2024) (“Virtual currencies, such as Bitcoin, have been determined to be commodities under the Commodity Exchange Act.”).

⁴⁴ I.R.S. Notice 2014-21, *supra* note 5.

⁴⁵ Parsons, *supra* note 17, at 11 (“Cryptocurrency and blockchain technology are not readily legible to the state. And this absence of legibility is what is presenting a challenge for tax law.”).

and regulated has become increasingly pressing as the adoption of these digital assets continues to grow.⁴⁶

B. Crypto as Property

In 2014 the IRS released Notice 2014-21, 2014-16 IRB 938, to provide guidance on the tax treatment of cryptocurrency. The notice clarifies that virtual currency is treated as property for federal tax purposes, and general tax principles applicable to property transactions — such as recognition of gain or loss upon the exchange of property — apply to transactions using virtual currency.⁴⁷ The notice also covers general fair market value and basis calculations with virtual currency⁴⁸ and rewards from mining and staking.⁴⁹ Further, the IRS recently clarified that a protocol upgrade to the consensus mechanism of a cryptocurrency blockchain that does not result in the issuance of new tokens or coins — usually by changing the blockchain from proof of work to proof of stake — does not result in gain, loss, or other income to a taxpayer who held cryptocurrency native to that blockchain.⁵⁰

If virtual currency is a capital asset in the hands of the taxpayer, a taxpayer will have a capital asset under section 1221,⁵¹ and transactions involving that asset — such as buying or selling — are subject to capital gains taxes.⁵² Capital losses from cryptocurrency can be used to offset capital gains from other investments, and if the losses exceed the gains, up to \$3,000 can be deducted against ordinary income in a tax year.⁵³ Any

⁴⁶ Mindy Herzfeld, *Beyond Digital: Is Cryptocurrency the Next Tax Frontier?* TAX NOTES FEDERAL, June 15, 2020, p. 1833 (“The novelty of virtual currency allows the IRS to revisit questions at the heart of the U.S. tax system, such as how to define property, securities, currency, and tax realization events. The government would be remiss in not taking the opportunity to reconsider those questions in a changing economy that now relies more heavily on digital and intangible assets for producing value.”).

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*; see also Paulger, *supra* note 3, at 642 (noting that rewards from mining and staking are initially treated as ordinary income, but any capital gains or losses from a subsequent sale of those rewards must be realized by the taxpayer).

⁵⁰ I.R.S. Gen. Couns. Mem. 202316008 (Apr. 21, 2023).

⁵¹ I.R.S. Notice 2014-21, *supra* note 5.

⁵² *Id.*; 28 U.S.C. § 1222. Specifically, if a taxpayer holds virtual currencies for over a year and sells or exchanges them, any profits or losses incurred will be considered long-term gains or losses. On the other hand, if the taxpayer sells or exchanges virtual currencies held for less than a year, any resulting gains or losses will be classified as short-term gains or losses. See also U.S. DEP’T OF THE TREASURY, SALES AND OTHER DISPOSITIONS OF ASSETS (2023).

⁵³ 28 U.S.C. § 1211.

remaining losses can be carried forward to offset future capital gains for up to 10 years.⁵⁴

C. Reporting Requirements, Enforcement

The IRS made clear in Notice 2014-21 that “a payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property.” In 2018 the IRS issued a news release to announce the establishment of an investigation team to focus on crimes involving cryptocurrencies and offer additional direction regarding the reporting obligations of taxpayers who participate in digital asset transactions.⁵⁵ As described in the 2018 news release, taxpayers must disclose any sales or exchanges of digital assets on their tax returns, irrespective of the value or whether a profit or loss was incurred.⁵⁶

The IRS has continued to remind taxpayers that they are required to disclose capital gains or losses from digital assets on Schedule D of Form 1040.⁵⁷ This includes cash-method taxpayers who receive rewards from staking cryptocurrency.⁵⁸ Further, a taxpayer must report cryptocurrency transactions on Form 8949, “Sales and Other Dispositions of Capital Assets.”⁵⁹ And in the 2019 tax year, the IRS added a mandatory question to the top of Form 1040 asking “At any time during 2019, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency?”⁶⁰ Neglecting to report digital asset transactions can lead to substantial fines and interest fees.⁶¹

Cryptocurrency held in jurisdictions outside the United States may trigger additional reporting requirements. For example, U.S. taxpayers

⁵⁴ 28 U.S.C. § 1212.

⁵⁵ I.R.S. Notice 2018-71.

⁵⁶ *Id.*

⁵⁷ I.R.S. Notice 2023-12.

⁵⁸ Rev. Rul. 2023-14; *see also* 2023-33 IRB 484 (staking rewards must be included in gross income for the tax year in which the taxpayer acquires dominion and control of the awarded cryptocurrency).

⁵⁹ I.R.S. Notice 2023-12; *see also* Stephen Ribble & Lesly Longa Vaillancourt, *Welcome to Your Digital Afterlife: Estate and Tax Planning for Digital Assets, Cryptocurrency, and NFTs*, 39 *GPSolo* 39, 40 (2022) (noting that the transfer of cryptocurrency from one wallet to another is not a taxable event and does not have to be reported).

⁶⁰ I.R.S., Form 1040 Schedule 1; *see also* I.R.S. Notice 2022-61. The IRS has since updated this question and has replaced “virtual currencies” with “digital assets.” *See* I.R.S. Notice 2023-12.

⁶¹ I.R.S. Notice 2014-21; *see also* 28 U.S.C. §§ 6662 (providing that a taxpayer who significantly underestimates their tax liability may face accuracy-related penalties), 6721-6772 (providing that a taxpayer who fails to timely or correctly report transactions may be subject to information reporting penalties).

with cryptocurrency held in foreign wallets or exchanges must report their financial interests in foreign bank accounts, including cryptocurrency accounts, if the total value of those accounts exceeds \$10,000 in a given year.⁶²

Also, the IRS has recently issued proposed regulations that would require brokers to report sales and exchanges of digital assets by customers, beginning in 2026.⁶³ These proposed regulations address various issues related to digital assets, including the definition of brokers and the requirement to report proceeds to the IRS using the new Form 1099-DA. They also outline rules for calculating gains or losses, determining basis, and implementing backup withholding for digital asset sales and exchanges. The purpose of these regulations is to assist taxpayers in determining their tax liabilities, sparing them from intricate computations or the need to use digital asset tax return preparation services when filing their tax returns.

The IRS has intensified its efforts to enforce cryptocurrency tax reporting, taking such measures as issuing John Doe subpoenas to brokerage firms to track down unreported cryptocurrency transactions.⁶⁴ The recently published 2023 annual report of IRS Criminal Investigation highlights the agency's unwavering dedication to ensuring the proper reporting of digital assets.⁶⁵ And IR-2019-132 revealed that the IRS had mailed "educational" letters to more than 10,000 taxpayers who may have neglected to report their income or pay taxes arising from virtual currency transactions, or failed to report them accurately.

III. FUTURE OUTLOOK ON TAXATION

A. Strategic Litigation: Jarrett

The absence of clear and definitive guidance on how to tax cryptocurrency is creating an environment in which crucial decisions on this matter may be determined through strategic litigation as both taxpayers and tax authorities seek to establish precedent and clarify the applicable tax rules.⁶⁶ Simultaneously, the IRS has increased its attention

⁶² U.S. DEP'T OF THE TREASURY, REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR) REFERENCE GUIDE (2022).

⁶³ Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 Fed. Reg. 73300 (proposed Oct. 25, 2023); 26 C.F.R. § 1.6045-1.

⁶⁴ Ribble & Vaillancourt, *supra* note 59, at 40; United States v. Coinbase Inc., 120 A.F.T.R. 2d 2017-6671 (N.D. Cal. 2017).

⁶⁵ I.R.S., 2023 ANNUAL REPORT(2023).

⁶⁶ Parsons, *supra* note 17, at 19 ("Strategic litigation by industry advocates is not the appropriate path forward for the taxation of cryptocurrency . . . but courts will

to and scrutiny of the taxation of cryptocurrency and the accuracy of taxpayers in reporting cryptocurrency transactions on their tax returns.⁶⁷ And following the collapse of FTX, scrutiny will only continue to increase.⁶⁸

A recent case, *Jarrett v. U.S.*,⁶⁹ illustrates the harms arising from a lack of legislative guidance on complex cryptocurrency taxation issues. The taxpayer, Joshua Jarrett, engaged in staking tezos tokens and receiving newly created tokens in return. He reported these tokens as income on his tax return but later claimed that staking income is not taxable and requested a refund. Jarrett filed a complaint seeking a refund after not receiving a timely response from the IRS. He argued that newly created tokens were not taxable at the time of receipt, but only at the time of sale. He further argued that creating new property is not an accession to wealth that is clearly realized and therefore is not taxable under U.S. tax law.

The Justice Department's Tax Division later approved a full refund of Jarrett's taxes, including interest. However, Jarrett refused to accept the refund because it did not provide any assurance on whether tokens created through staking activities are taxable at the time of creation. The district court ultimately dismissed the case, stating that Jarrett's claim was moot because he had already received a full refund, and the Sixth Circuit upheld that decision.

As more cases like *Jarrett* inevitably come before the courts, judges will soon find themselves in the position of having to assign a tax category to cryptocurrency. This is no small matter, as the crypto industry has significant implications for American taxpayers.⁷⁰ As industry

be the ones making these decisions if Congress and the Biden Administration do not act quickly.”).

⁶⁷ See *supra* Section III.C. See also Mark Friedlich, *IRS Increases Cryptocurrency Activity Scrutiny, Gives Loss Deduction and NFT Tax Treatment Guidance*, WOLTERS KLUWER (Mar. 23, 2023), <https://www.wolterskluwer.com/en/expert-insights/irs-increases-cryptocurrency-activity-scrutiny-gives-loss-deduction-and-nft-tax-treatment-guidance> (“The IRS has been significantly increasing its scrutiny of cryptocurrency and other digital currency transactions in recent years, and this trend will accelerate this year and beyond.”).

⁶⁸ REUTERS, *After FTX Collapse, Pressure Builds for Tougher Crypto Rules* (Dec. 2, 2022), [https://www.reuters.com/business/finance/after-ftx-collapse-pressure-builds-tougher-crypto-rules-2022-12-02/#:~:text=Dec%20%20\(Reuters\)%20%2D%20Regulators,a%20sector%20prone%20to%20meltdowns.](https://www.reuters.com/business/finance/after-ftx-collapse-pressure-builds-tougher-crypto-rules-2022-12-02/#:~:text=Dec%20%20(Reuters)%20%2D%20Regulators,a%20sector%20prone%20to%20meltdowns.;); Mike Belshe, *FTX Collapse Spurs Calls for U.S. Crypto Regulation*, COINDESK (Jan. 25, 2023), <https://www.coindesk.com/consensus-magazine/2023/01/24/us-crypto-regulation-approach/>.

⁶⁹ *Jarrett v. United States*, 79 F.4th 675 (6th Cir. 2023).

⁷⁰ See Parsons, *supra* note 17, at 17 (“How [cases like *Jarrett* are] handled will have major implications for the U.S. tax system in moving forward.”).

advocates continue to press their cases, the pressure on judges to get this right will only increase.⁷¹ The federal courts are not the appropriate institution to address this issue; requiring judges to improvise a tax scheme from scratch is a challenging task that risks creating a disjointed and inconsistent system.⁷² *Jarrett* highlights the ambiguity surrounding the taxation of cryptocurrency and the need for Congress and Treasury to intervene by developing a comprehensive and well-coordinated framework for taxing cryptocurrency and blockchain.⁷³

B. New Tax Laws for Cryptocurrency

Given the complexity of cryptocurrency and the lack of legislative guidance, drafting and implementing tax laws specific to crypto is still a work in progress, and policymakers will need to consider various factors to ensure that the regulations strike a balance between encouraging innovation and protecting taxpayers. Some notable legislation includes the Infrastructure Investment and Jobs Act of 2021, the first mention of cryptocurrencies in U.S. legislation, which requires brokers to report crypto transactions worth more than \$10,000 to the IRS.⁷⁴ Another example is the Virtual Currency Tax Fairness Act of 2022, which proposed a tax exemption for gains on transactions of less than \$200.⁷⁵ The Token Taxonomy Act of 2021 similarly proposed to exclude gains of up to \$600 from virtual currency transactions.⁷⁶ That bill also would have allowed like-kind exchanges of cryptocurrency under section 1031.⁷⁷ Practitioners should remain aware of changes in laws to give clients the most up-to-date advice.

⁷¹ Lee Reiner, *10 Things Judges Should Know About Cryptocurrency*, 106 JUDICATURE 63 (2022) (“The cryptocurrency sector has evolved rapidly since, raising novel legal and jurisdictional issues that judges across the country are grappling with.”).

⁷² Parsons, *supra* note 17, at 19 (“Allowing the federal judiciary to create piecemeal a system for taxing cryptocurrency will lead to a scattered, incoherent taxing scheme with unintended ramifications.”).

⁷³ *Id.* at 18 (noting that Treasury and Congress are best suited to create a regulatory scheme because of “the technical complexity of tax law” and because, “as institutions, Congress and Treasury also provide the opportunity for more voices and interests to be heard than if cryptocurrency taxation is developed via strategic litigation,” among other reasons).

⁷⁴ 26 U.S.C. §§ 6045, 6050I.

⁷⁵ H.R. 6582, 117th Congress (2022). Prior versions of this legislation were proposed as the Cryptocurrency Tax Fairness Act.

⁷⁶ H.R. 1628, 117th Congress (2021).

⁷⁷ The Tax Cuts and Jobs Act of 2017 limited like-kind exchanges to real property, which does not include cryptocurrency.

C. Cryptocurrency as Legal Tender

Under Notice 2014-21, cryptocurrency is treated as property, not currency. With the 2021 adoption of bitcoin as legal tender in El Salvador,⁷⁸ it is hoped that we are gaining more insight into the possible effects of accepting cryptocurrency as legal tender.⁷⁹ This historic decision also raised questions about how other nations might respond, with the Central African Republic following suit and experts predicting that other countries could soon adopt similar measures.⁸⁰

It may be argued that the U.S. government could benefit from taking a cue from El Salvador and recognizing cryptocurrency as legal tender. However, there are several challenges associated with crypto that make its acceptance as legal tender a complicated debate, including price volatility,⁸¹ monetary policy,⁸² regulatory difficulties,⁸³ and the potential for illegal activity.⁸⁴ Further, there would need to be widespread

⁷⁸ THE ASSOCIATED PRESS, *El Salvador Becomes First Nation to Make Bitcoin Legal Tender*, N.Y. TIMES (June 9, 2021), <https://www.nytimes.com/2021/06/09/world/americas/salvador-bitcoin.html> (“El Salvador’s Legislative Assembly has approved legislation making the cryptocurrency Bitcoin legal tender in the country, the first country to do so.”).

⁷⁹ Jesse C. Hubers, “Everything We Know — and Don’t — About Taxing Cryptocurrency,” *Tax Notes Federal*, Apr. 3, 2023, p. 1699 (suggesting that El Salvador’s adoption of bitcoin as legal tender “could affect future guidance on the tax classification of bitcoin, tax planning, foreign bank account reporting, and foreign asset disclosure”).

⁸⁰ BBC, *Bitcoin Becomes Official Currency in Central African Republic* (Apr. 27, 2022), <https://www.bbc.com/news/world-africa-61248809> (“The Central African Republic (CAR) has approved Bitcoin as legal tender.”).

⁸¹ Economic report of the president, *supra* note 24, at 252 (“Cryptocurrencies currently experience substantial amounts of volatility, and thus are not stable stores of value.”).

⁸² Although crypto’s origins come from wanting to do away with a central bank, a central bank is key for the government’s ability to put in place monetary policy and control the quantity of money available in the economy. Thus, accepting crypto as legal currency may undermine the Federal Reserve system’s economic goal and strip it of its power. Paulger, *supra* note 3, at 659.

⁸³ Brian Armstrong, *OpEd: Crypto Markets Need Regulation to Avoid More Washouts Like FTX, Says Coinbase CEO Brian Armstrong*, CNBC (Nov. 11, 2022), <https://www.cnbc.com/2022/11/11/op-ed-crypto-markets-need-regulation-to-avoid-ftx-type-situations.html#:~:text=Crypto%20regulation%20in%20the%20U.S.,argues%20Coinbase%20CEO%20Brian%20Armstrong>. (“Crypto regulation in the U.S. has been hard to navigate, and regulators have so far failed to provide a workable framework for how these services can be offered in a safe, transparent way.”).

⁸⁴ COUNCIL OF ECON. ADVISERS, *supra* note 24, at 266 (“Because [an] attacker can demand that crypto assets be sent to a pseudonymous wallet instead of a bank

acceptance of cryptocurrency as a form of currency among the people, which is not the case.⁸⁵ And if crypto were to be classified as currency, the United States could potentially lose out on significant tax income.⁸⁶ The IRS recently reaffirmed that digital currency is not currency for U.S. tax purposes.⁸⁷ And in light of the 2023 economic report of the president, the federal government has made clear that it is not adopting cryptocurrency as legal tender anytime soon.⁸⁸

D. Cryptocurrency as an Asset Class

Some experts have suggested that cryptocurrency be reclassified as its own asset class because of its unique nature.⁸⁹ Recognizing cryptocurrency as a distinct asset class may help to reduce regulatory uncertainty, clarify the rules and requirements that apply to it, and potentially attract more institutional investors to the market, which could bring increased liquidity and stability.⁹⁰ However, there are challenges

account linked to a specific person, attackers can more easily launder or obfuscate payments made to them, in comparison with fiat currency.”).

⁸⁵ *Id.* at 252 (“In the United States, [cryptocurrencies] are not as effective a medium of exchange as the U.S. dollar. This is because they can be used to purchase other cryptocurrencies and to buy goods and services at a smaller number of firms relative to the U.S. dollar.”).

⁸⁶ See Alex Ankier, *Debugging IRS Notice 2014-21*, 85 BROOK. L. REV. 883, 902 (2020).

⁸⁷ Under I.R.S. Notice 2023-34, 2023-19 IRB 837, the virtual currency addressed in I.R.S. Notice 2014-21 is no longer described as not having “legal tender status in any jurisdiction.” The modification in I.R.S. Notice 2023-34 does not change the IRS’s view that “convertible virtual currency” is not a currency and cannot generate foreign currency gain or loss for U.S. federal tax purposes.

⁸⁸ COUNCIL OF ECON ADVISERS, *supra* note 24, at 251 (noting that although cryptocurrencies act as a benchmark on which the values of different goods and services can be compared, as a medium of exchange, and as a store of value, “they only do so in limited ways in the United States, so they do not serve, from an economic perspective, as an effective alternative to the U.S. dollar”).

⁸⁹ See Ankier, *supra* note 86, at 906 (suggesting a three-tier framework for taxing cryptocurrency as its own asset class). See also Paulger, *supra* note 3, at 662; Brandy Betz, *Bank of America Launches Research for ‘Too Large to Ignore’ Digital Assets*, COINDESK (Oct. 4, 2021), <https://www.coindesk.com/business/2021/10/04/bank-of-america-launches-research-for-too-large-to-ignore-digital-assets/> (“We believe crypto-based digital assets could form an entirely new asset class.”); Allison Nathan, *Crypto: A New Asset Class?*, GOLDMAN SACHS (May 21, 2021), https://www.3bit-lab.com/documents/goldman-sachs_crypto-a-new-asset-class_20210501.pdf.

⁹⁰ THE ECON. TIMES, *ETMarkets Crypto Conclave: Is Crypto to Be Considered Seriously as an Asset Class?* (Mar. 31, 2022, 5:28:00 PM), <https://economictimes.indiatimes.com/markets/cryptocurrency/etmarkets-crypto-conclave-is-crypto-to-be-considered-seriously-as-an-asset-class/articleshow/90568319.cms?from=mdr>.

associated with creating a new asset class — primarily, the time required to do so.⁹¹ Moreover, determining all the rules that should be in place for crypto is a challenge because it is still a relatively new concept.⁹² Nonetheless, with these challenges in mind, the potential benefits make it a worthwhile endeavor for Congress to consider.

IV. ESTATE PLANNING CONSIDERATIONS

There are unique aspects of crypto assets that set them apart from traditional assets and require special attention in estate planning. Estate planners should create a plan that effectively manages a decedent's crypto assets to avoid significant and costly tax consequences for clients.

The challenges faced by Matthew Mellon's estate highlight the significance of adequate estate planning when cryptocurrency assets are involved.⁹³ Mellon died in April 2018, leaving behind an estate valued at approximately \$200 million. His wealth was largely derived from a \$2 million investment in XRP, a cryptocurrency managed by ripple. Unfortunately, Mellon's will was outdated and did not account for his cryptocurrency holdings. It was discovered after his death that he kept the keys to his XRP on different devices under various names, making it challenging to access. Fortunately, Mellon's lawyers collaborated with ripple to gain access to the cryptocurrency. However, such access is uncommon without prior planning. In the weeks following Mellon's death, the value of XRP fluctuated by around 30 percent. It was essential to liquidate the cryptocurrency quickly to cover his outstanding debts, income tax obligations, and estate taxes. However, Mellon had an agreement with ripple limiting the amount of XRP that could be sold at a time, delaying the process. By the end of 2019, with XRP losing about two-thirds of its value, the value of his estate had decreased by more than half.

If Mellon had informed his advisers and trusted individuals about his cryptocurrency holdings, they could have created a plan that did not entirely rely on XRP to fulfill his obligations. Moreover, if his fiduciaries could have gained access to the cryptocurrency earlier, they might have

⁹¹ Paulger, *supra* note 3, at 662 (“As crypto grows in popularity, the general public and professionals will begin incorporating this technology into life and business, so it is likely [a governmental agency like the SEC or CFTC] will need to be formed in the near future.”).

⁹² *Id.*

⁹³ See Grace Ferguson, *How a Cryptocurrency Fortune Crippled a Deceased Billionaire's Estate*, DAILY DOT (Dec. 23, 2021), <https://www.dailydot.com/irl/death-internet-cryptocurrency-matthew-mellon/>.

sold it when its value was higher, reducing the losses suffered by Mellon's estate.

A. Asset Distribution Challenges

1. Fiduciary concerns.

An estate planner is a fiduciary — someone who is appointed to act on behalf of the beneficiary, with a legal duty to act in the beneficiary's best interests.⁹⁴ With the proliferation of online bank and brokerage accounts, digital assets, and NFTs, management of a client's assets has become increasingly more complicated. Among other things, fiduciaries now have a responsibility to investigate and identify cryptocurrency assets.⁹⁵

Further, several potential ethical considerations can arise in the context of cryptocurrency estate planning. Notably, there may be a potential conflict of interest or risk of self-dealing when managing crypto assets because estate planners may be tempted to prioritize their own financial interests over those of their clients, particularly if they have a personal stake in the crypto assets in question.⁹⁶

It is important for estate planners to establish clear policies and procedures for managing crypto assets, including disclosure requirements, conflict of interest rules, and oversight mechanisms. Estate planners should also consider obtaining independent valuation and appraisal services to ensure that crypto assets are being managed and distributed

⁹⁴ See Stacy E. Singer & Fredrick B. Weber, *RUFADAA, Bitcoin and Fiduciaries: Finding the True Meaning of 'Digital Assets' in Estates and Trusts*, 48 TAX MGMT. ESTS. GIFTS & TR. J. 1 (2023) ("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.").

⁹⁵ See *id.* at *1 ("A trustee now has an obligation to investigate and identify crypto assets."); see also Gerry W. Beyer & Kerri G. Nipp, *Cyber Estate Planning and Administration*, 43 TAX MGMT. ESTS. GIFTS & TR. J. 3 (2018) ("Fiduciaries managing digital assets are subject to the fiduciary duties of care, loyalty, and confidentiality.").

⁹⁶ RESTATEMENT (SECOND) OF TRUSTS § 170 (1959) ("A trustee is in a fiduciary relation to the beneficiary and as to matters within the scope of the relation he is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do so by the terms of the trust or by a proper court."); see also *In re Marriage of DeSouza*, 266 Cal. Rptr. 3d 890, 898 (Ct. App. 2020) (holding that a husband breached his fiduciary duty of loyalty to his former wife by secretly transferring cryptocurrency assets during their divorce proceedings).

fairly and equitably.⁹⁷ Also, estate planners should stay up to date on the latest developments in cryptocurrency regulations and best practices to ensure that they are providing the most ethical and effective services possible.

2. Locating, gaining access to, and taking control of digital assets.

Before thinking about the most tax-efficient way to distribute a client's cryptocurrency, it is necessary for an estate planner to gather all relevant information about the client's assets. As exemplified by Mellon's estate, estate planners may face difficulties in locating and accessing digital assets, especially if the deceased did not provide clear instructions on where to find them or how to gain access.⁹⁸

Accessing digital assets without proper authorization or legal authority can be illegal, and estate planners must navigate complex privacy and security laws.⁹⁹ To assist fiduciaries, the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA) provides a framework for fiduciaries to access digital assets in certain circumstances, while also providing privacy protections for the owner of the digital assets.¹⁰⁰ Under RUFADAA, a person must designate in their estate planning documents who will have access to their digital assets after they die or become incapacitated.¹⁰¹ If no such designation is made, the service provider's terms of service will control the fiduciary's access to the digital assets.¹⁰²

⁹⁷ *Id.*

⁹⁸ Ferguson, *supra* note 93; *see also* Singer and Weber, *supra* note 94, at *11 ("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.").

⁹⁹ Notably, fiduciaries may be subject to criminal sanctions for violations of the Stored Communications Act (SCA), 18 U.S.C. section 2701 and the Computer Fraud and Abuse Act (CFAA), 18 U.S.C. section 1030. Under both federal statutes, fiduciaries must obtain "lawful consent or authorization to access an electronic communication (SCA) or a computer (CFAA)." Beyer and Nipp, *supra* note 95, at 6-7.

¹⁰⁰ Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA) section 15, Uniform Law Commission (2015). As of October 2023, RUFADAA had been enacted in 45 states, with only California, Delaware, Louisiana, Massachusetts, and Oklahoma yet to pass the current version. Fiduciary Access to Digital Assets Act, Revised, Uniform Law Commission (2015).

¹⁰¹ *Id.*; *see also* Beyer and Nipp, *supra* note 95, at 11 ("RUFADAA places great emphasis upon whether the deceased or incapacitated user expressly consented to the disclosure of the content of the digital assets.").

¹⁰² Beyer and Nipp, *supra* note 95, at 13 ("If the user has not provided instructions through an online tool or written record, then the service provider's [terms of

Put simply, 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.”¹⁰³

To ensure the proper management and distribution of digital assets in an estate an estate planner should encourage their clients to maintain an inventory of all digital assets and accounts, including login information and passwords, which should be regularly reviewed and updated as necessary.¹⁰⁴ The estate planner should also ensure that the client’s estate planning documents provide adequate instructions on how to access and distribute the decedent’s digital assets, as well as information regarding who should be responsible for managing them.¹⁰⁵

3. *Valuation concerns.*

As noted above, Mellon’s estate suffered significant financial harm as a result of fluctuations in the price of the decedent’s crypto holdings.¹⁰⁶ Because crypto is treated as property for federal income tax purposes, its estate tax value will be its fair market value (FMV) as of the owner’s date of death or as of the alternate valuation date if the fiduciary elects to use alternate valuation on the federal estate tax return.¹⁰⁷ Calculating a cryptocurrency’s FMV is analogous to calculating the FMV of marketable securities such as stocks, bonds, and mutual funds.¹⁰⁸ However, there are additional challenges unique to cryptocurrencies that make their valuation more difficult than for typical securities. First, unlike exchanges for marketable securities, virtual currency markets and exchanges are traded twenty-four hours a day, seven days a week, making

service agreement] will govern the rights of the user’s fiduciaries.”).

¹⁰³ Singer and Weber, *supra* note 94, at 10.

¹⁰⁴ *See id.* at 12 (suggesting that estate planners encourage their clients to deposit crypto assets with a custodian, such as Coinbase, to perform functions similar to traditional brokerage accounts, such as facilitating transfers of virtual currency at death).

¹⁰⁵ *See id.* at 10-11 (providing sample language to be included in an estate plan that would allow a fiduciary to access a decedent’s accounts under RUFADAA).

¹⁰⁶ Ferguson, *supra* note 93 (“By the end of 2019, the estate was worth less than half of its original \$197 million value as the liquidation continued and the price of XRP dropped to its lowest point since Mellon died. At 19 cents per unit, it had lost more than two-thirds of its value.”).

¹⁰⁷ Singer and Weber, *supra* note 94, at 13.

¹⁰⁸ *Id.* (citing 26 C.F.R. § 20.2031-2(b)(1)) (“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.”).

calculating the FMV under the same valuation rules impossible.¹⁰⁹ Moreover, crypto prices can fluctuate rapidly, sometimes within minutes or hours, which can make it difficult to accurately value digital assets at the time of the owner's death or the time of sale.¹¹⁰ The IRS has issued guidance on this issue and taken the position that the FMV of cryptocurrency received in a transaction facilitated by a cryptocurrency exchange is determined by the trading price of the cryptocurrency on the exchange at the specific date and time when the transaction would have been recorded on the blockchain ledger.¹¹¹ Thus, a fiduciary will not only need to know the date of death but the exact time of death.¹¹² Estate planners may need to work with appraisers or financial professionals to determine the FMV of the digital assets and develop a strategy for selling them over time to mitigate the impact of market volatility.

4. Liquidity issues.

Another issue illustrated by the Mellon estate: Crypto liquidity can affect the ability to quickly and easily sell the assets and distribute the proceeds to heirs or beneficiaries.¹¹³ Notably, not all cryptocurrencies have the same liquidity. Some cryptocurrencies are traded on major exchanges with high trading volumes and liquidity, while others are available only on smaller, less liquid exchanges or through peer-to-peer transactions.¹¹⁴ And

¹⁰⁹ *Id.*

¹¹⁰ See, e.g., Pawan Nahar, *Up 67,000 Percent In Just 24 Hours! Cryptocurrency's Mind-Boggling Rally Raises Red Flags*, THE ECONOMIC TIMES (Nov. 15, 2021), <https://economictimes.indiatimes.com/markets/cryptocurrency/up-67000-in-just-24-hours-cryptocurrencys-mind-boggling-rally-raises-red-flags/articleshow/87714980.cms?from=mdr> (reporting that HuskyX, a cryptocurrency, “has delivered about 67,000 per cent return in the last 24 hours.”).

¹¹¹ I.R.S. Notice 2014-21, Q-26. If cryptocurrency is received in a peer-to-peer transaction that is not facilitated by a blockchain ledger, the IRS allows a fiduciary to use evidence of an “explorer value” as of the date and time of the transfer. *Id.* at Q-27.

¹¹² Singer and Weber, *supra* note 94, at 13.

¹¹³ Corporate Finance Institute, *Liquidity in Cryptocurrency*, Feb. 1, 2023, <https://corporatefinanceinstitute.com/resources/cryptocurrency/liquidity-in-cryptocurrency/> (“Liquidity in cryptocurrency means the ease with which a digital currency or token can be converted to another digital asset or cash without impacting the price and vice-versa.”).

¹¹⁴ For example, peer-to-peer exchanges allow cryptocurrency traders to trade directly with one another without the need for a centralized third party to facilitate the transactions. These exchanges “typically have lower liquidity than centralized exchanges [because] there may not always be someone available to match [a] trade order.” Marcel Deer, *What Is P2P Trading, and How Does it Work in Peer-to-Peer Crypto Exchanges?*, COINTELEGRAPH (May 17, 2022), <https://cointelegraph.com/news/what-is-p2p-trading-and-how-does-it-work-in-peer-to->

in rare cases like Mellon's, restrictions may be placed on an individual's ability to engage in crypto trading.¹¹⁵ Estate planners may need to assess the liquidity of the digital assets in the estate and determine the best strategy for selling them in a way that maximizes value for the beneficiaries.

5. Cybersecurity threats.

Digital assets can be vulnerable to hacking, phishing, and other cyberattacks.¹¹⁶ Estate planners need to take appropriate measures to protect their clients' digital assets from potential threats, such as by having their clients consider storing assets in a cold wallet¹¹⁷ or purchasing cyber insurance.¹¹⁸

B. Planning Strategies

When managing cryptocurrency assets in an estate, estate executors or administrators can use various strategies to minimize tax liability and ensure compliance with relevant laws and regulations.

1. Planning with a will.

In the simple case in which a decedent wishes to leave his or her entire estate to a single individual, the decedent may simply create a will to bequeath the assets. With the current lifetime estate and gift exemption for single filers at \$12.92 million,¹¹⁹ a taxpayer can leave up to that amount to heirs and pay no federal estate taxes on the transfer.¹²⁰ To plan with a will, one should create an inventory of all cryptocurrency assets, designate a beneficiary or beneficiaries for the cryptocurrency, provide instructions for transferring the cryptocurrency, and include a "digital executor" to

peer-crypto-exchanges.

¹¹⁵ Ferguson, *supra* note 93.

¹¹⁶ Economic report of the president, *supra* note 24, at 266 (noting that hacking to receive crypto assets has continued to become more widespread); *see also* U.S. Dep't of Just. *Two Arrested for Alleged Conspiracy to Launder \$4.5 Billion in Stolen Cryptocurrency* (Feb. 8, 2022), <https://www.justice.gov/opa/pr/two-arrested-alleged-conspiracy-launder-45-billion-stolen-cryptocurrency#:~:text=The%20criminal%20complaint%20alleges%20that,take%20place%20in%20a%20short>.

¹¹⁷ *See supra* Section II.D.

¹¹⁸ Economic report of the president, *supra* note 24, at 266.

¹¹⁹ Rev. Proc. 2022-38, 2022-45 IRB 445.

¹²⁰ *Id.*; *see* Freeman Law, *supra* note 7 (noting that anything above the lifetime estate and gift exemption "will be taxed at graduated rates, with any amounts over a million taxed at the 40 percent top rate.").

manage the digital assets after death.¹²¹ It's important to keep the will up to date and make efforts to minimize any tax implications associated with the transfer of cryptocurrency assets.

2. *Planning with a trust.*

Estate planning with cryptocurrency can also be accomplished through the use of a trust. Using trusts to hold cryptocurrency assets might provide greater control over the distribution of assets while reducing the taxable estate. Fiduciaries overseeing crypto assets in a trust, however, must also abide by the prudent investor rule.¹²² Given cryptocurrency's high volatility and susceptibility to hacking, some experts speculate that crypto is not appropriate for a prudent investor portfolio.¹²³ To ensure the crypto assets are not sold while in the trust, the trust document should specify how the cryptocurrency assets will be managed, who the beneficiaries are, and when and how the assets will be distributed.¹²⁴ It's important to appoint a trustee who is familiar with cryptocurrency and has experience managing digital assets. As with a will, it's important to review and update a trust regularly to ensure that it accurately reflects the wishes of a decedent and the current state of any cryptocurrency assets. Further, a trust may also be subject to a trust tax, which can affect the overall tax liability of the estate.¹²⁵ Estate planners should stay up to date on upcoming tax laws that could affect the use of trusts.¹²⁶

¹²¹ Freewill, *Estate Planning for Cryptocurrency: How to Include Crypto Assets in Your Estate Plan*, Nov. 3, 2022, <https://www.freewill.com/learn/estate-planning-for-cryptocurrency> (suggesting crypto investors name a “digital executor” in their wills to manage their digital property after they die).

¹²² RESTATEMENT (THIRD) OF TRUSTS § 90 (2007) (“The trustee has a duty to preserve the trust property and to make it productive. In doing so the trustee must exercise reasonable care, skill, and caution and must act with undivided loyalty to the beneficiaries and with impartiality among them.”); *see also* Singer and Weber, *supra* note 94, at 17 (advising estate planners drafting a trust to include language permitting investments in blockchain assets so a fiduciary can manage them as needed).

¹²³ Singer and Weber, *supra* note 94, at 16-17.

¹²⁴ *See* Paulger, *supra* note 3, at 656.

¹²⁵ 26 U.S.C. § 641.

¹²⁶ For example, some estate planners have commented on how the Build Back Better Act would directly affect trusts. *See* Jacqueline Yu Law, *Status of Build Back Better Act and the Landscape of 2022 Estate and Gift Tax Laws* Mar. 30, 2022, <https://www.jacquelineyulaw.com/status-of-build-back-better-act-and-the-landscape-of-2022-estate-and-gift-tax-laws> (explaining various implications of the Build Back Better Act on trusts, including increased income tax for trusts and a new surtax on multimillionaires and billionaires).

3. *Planning with an LLC.*

Using a limited liability company (LLC) to hold cryptocurrency is another effective strategy because it can offer several benefits.¹²⁷ First, it provides limited liability protection for the cryptocurrency assets, which can help shield personal assets from potential liabilities related to the cryptocurrency. Second, it allows for greater flexibility in terms of management and ownership of the cryptocurrency. Members of the LLC can buy, sell, and transfer cryptocurrency without having to go through the probate process, which can be time-consuming and expensive. Finally, an LLC can help facilitate the transfer of cryptocurrency assets to beneficiaries after the owner's death, without the need for a court-supervised probate process.¹²⁸

4. *Gifting crypto.*

Although planning with a will or trust may be effective ways to distribute a decedent's digital assets, they may not be the most tax-efficient. Assets are valued on the date of death, and a decedent's beneficiary may have a step-up basis in the assets acquired from an estate.¹²⁹ This could negatively affect a beneficiary if the crypto asset is volatile and has a high value on the date of death but quickly drops in price. One strategy to reduce the overall value of the estate and any potential estate tax liability is by gifting cryptocurrency assets to beneficiaries during the lifetime of the estate owner. When one gifts cryptocurrency, the transferee does not have any gain to report, and the transferee takes a transferred basis.¹³⁰ It is important to consider that gifting cryptocurrency may also trigger a gift tax, which can offset the tax benefits of this strategy.¹³¹

5. *Charitable contributions.*

Charitable contributions of appreciated cryptocurrency assets to qualified organizations under section 170 can be an effective strategy for lowering a client's tax liability while supporting a desired cause. By donating appreciated cryptocurrency to public charities and certain private

¹²⁷ See Singer and Weber, *supra* note 94, at 22.

¹²⁸ Amy Kalnoki, *Guide to Owning Crypto in an LLC: Benefits, Risks, and Tax Tips*, BITWAVE, <https://www.bitwave.io/blog/guide-to-owning-crypto-in-an-llc-benefits-risks-and-tax-tips>.

¹²⁹ 26 U.S.C. § 1014.

¹³⁰ 26 U.S.C. § 1015.

¹³¹ 26 U.S.C. § 2501. However, for 2024, taxpayers are allowed to give up to \$18,000 per person annually without having to file a gift tax return or pay any gift taxes. And exceeding this limit does not trigger gift taxes unless the taxpayer has already used up the entire lifetime estate tax exemption of \$13.51 million. See Rev. Proc. 2023-34, 2023-48 IRB 1287.

foundations, taxpayers can avoid paying capital gains taxes on the appreciation while still receiving a deduction for the full FMV of the donated cryptocurrency.¹³² This can be particularly advantageous for those who have held on to cryptocurrency for a long time and have seen a significant appreciation in value.

To claim a charitable contribution deduction, taxpayers must fulfill certain requirements.¹³³ For instance, if a taxpayer donates property for which a deduction of more than \$5,000 is claimed, they must obtain a qualified appraisal of the property for the tax year in which the contribution is claimed.¹³⁴ A readily ascertainable value based on the value published by a cryptocurrency exchange is not a substitute for a qualified appraisal.¹³⁵ However, it is still unclear who constitutes a qualified appraiser under section 170.¹³⁶ Estate planners should advise their clients on the potential tax benefits of donating cryptocurrency to charity and provide guidance on how to ensure that their donations are made to qualified organizations.

6. Lending cryptocurrency.

Cryptocurrency lending can be a method to generate passive income while avoiding capital gains. Discussed above, a taxable event occurs only upon the disposition of cryptocurrency.¹³⁷ In the context of cryptocurrency loans, one can either borrow cash and pledge their cryptocurrency or lend their cryptocurrency and take out cash collateral. The latter could be considered a taxable crypto event. However, in the first scenario, the crypto is not actually sold. As a result, this action does not trigger any capital gains.¹³⁸ This may be a powerful tax planning tool,

¹³² 26 U.S.C. § 170; I.R.S. Gen. Couns. Mem. 202302012.

¹³³ I.R.S. Gen. Couns. Mem. 202302012; *see* §§ 170(f)(8), (11).

¹³⁴ *Id.*

¹³⁵ *See id.* (noting that cryptocurrency does not fall into the readily marketable security exception for obtaining an appraisal).

¹³⁶ *See* 26 C.F.R. § 1.170A-17(b) (defining a qualified appraiser as an individual with verifiable education and experience in valuing the type of property for which the appraisal is performed); EY, US IRS Addresses Deductions Involving Cryptocurrency in Two Chief Counsel Advice Memos, Feb. 1, 2023, https://www.ey.com/en_gl/tax-alerts/us-irs-addresses-deductions-involving-cryptocurrency-in-two-chie (“For cryptocurrency, it is unclear what sort of qualifications would be required, considering that accredited professional or college-level coursework on cryptocurrency valuation is not widely available and no recognized appraiser designation for cryptocurrency appraisers yet seems to exist.”).

¹³⁷ *See supra* Section III.B.

¹³⁸ Miles Brooks, *Do I Need to Pay Taxes on Crypto Loans?* COINLEDGER, <https://coinedger.io/blog/crypto-loans-taxes#:~:text=crypto%20loan%20>

particularly for individuals who have held cryptocurrency for less than 12 months and who may use crypto lending to sidestep short-term capital gains taxes while retaining their digital assets.¹³⁹

Still, there may be tax consequences from crypto loans. Much like gains from mining or staking,¹⁴⁰ if one lends cryptocurrency and receives interest or other income in return, that income is generally taxable as ordinary income.¹⁴¹ Similarly, if the value of the cryptocurrency used as collateral drops below a predetermined threshold, the exchange will have the option to liquidate, and the borrower will have to pay any capital gains taxes resulting from the disposition of the collateral.¹⁴² And if the loan is not repaid, the borrower may have cancellation of debt income.¹⁴³

However, the full-breadth tax consequences of cryptocurrency lending are a gray area that the IRS has yet to issue guidance on, leaving many questions unanswered. For example, the tax consequences of outstanding crypto loans at the time of death are not yet clear. Further, the tax consequences of unwinding crypto loans remain unclear. And although crypto loan interest payments would likely be treated the same way as any other interest expense if the user engaged in a borrowing of cash and pledged any asset, the IRS has yet to provide guidance on whether crypto loan interest payments are considered tax deductible.¹⁴⁴

7. Using tax-advantaged accounts.

providers.-,Are%20crypto%20loans%20taxable%3F,non%2Dtaxable%20by%20the%20IRS.

¹³⁹ *Id.*

¹⁴⁰ Indeed, crypto lending is distinct from mining and staking. Although both methods offer ways to generate passive income with cryptocurrencies, cryptocurrency lending involves loaning your digital assets to others for interest, while staking involves participating in the network's consensus mechanism by locking up your tokens to support network operations and earning rewards in return. *See supra* Section II.C.

¹⁴¹ Brooks, *supra* note 138.

¹⁴² Bitcoin Taxes, *Crypto Loan Taxes in 2022 – A Sneaky Tax Saving Strategy?*, Mar. 27, 2022, <https://bitcoin.tax/blog/crypto-loan-taxes/#:~:text=Crypto%20Loan%20Taxes%20on%20Interests,will%20not%20be%20tax%2Ddeductible>.

¹⁴³ 26 U.S.C. § 108; Kalnoki, *How Crypto Loans Affect Your Taxes: Everything You Need to Know*, BITWAVE (Feb. 20, 2023), <https://www.bitwave.io/blog/the-ultimate-guide-to-crypto-loan-taxes>.

¹⁴⁴ Some speculate that interest paid on the loan can be written off as an expense on the tax return if the loan amount is used for investment or business purposes under section 162. *E.g.*, Kalnoki, *supra* note 143; CoinTracking, *The Tax Guide to Crypto Loans*, Mar. 29, 2023, <https://cointracking.info/crypto-taxes-us/crypto-loans-taxes/#:~:text=In%20the%20US%2C%20borrowing%20money,it%20qualifies%20as%20investment%20interest>.

Using tax-advantaged accounts, such as IRAs, to hold cryptocurrency assets can provide tax benefits by deferring taxes on any gains until the assets are withdrawn. For example, an owner holding crypto in a Roth IRA does not have to pay taxes on any gains, subject to limitations.¹⁴⁵ Similarly, if the owner were to hold the crypto in a traditional IRA, taxes would be paid only when funds are withdrawn in retirement.¹⁴⁶ Notably, there are specific rules and limitations on using tax-advantaged accounts to hold cryptocurrency assets.¹⁴⁷ Further, contributions to and withdrawals from these accounts may also be subject to restrictions and penalties.¹⁴⁸

8. *Timing transactions.*

Timing transactions to take advantage of lower tax rates is another strategy that can help minimize tax liability. For example, selling in a low-income year may result in a lower tax liability. Also, selling cryptocurrency that has decreased in value can offset gains from other investments and reduce overall tax liability.

Tax-loss harvesting can be a useful strategy for offsetting gains on winning investments with losses on losing ones. However, fiduciaries should be wary of wash sales of cryptocurrency.¹⁴⁹ A wash sale occurs when a holder of crypto or a security sells it at a loss to gain tax benefits and then quickly buys the same or similar asset.¹⁵⁰ Despite crypto wash sales being technically allowed,¹⁵¹ the crypto wash sale rule is still a gray area, and some speculate that “given recent rulings on crypto cases and the Build Back Better Act, it is reasonable to expect that crypto wash sales will soon be declared illegal.”¹⁵² Thus, although wash sales may minimize

¹⁴⁵ Henry Yoshida, *Retirement Accounts Offer Tax-Advantaged Investing as IRS Ramps Up Cryptocurrency Tracking*, FORBES, (Nov. 30, 2020), <https://www.forbes.com/sites/forbesfinancecouncil/2020/11/30/retirement-accounts-offer-tax-advantaged-investing-as-irs-ramps-up-cryptocurrency-tracking/>.

¹⁴⁶ *Id.*

¹⁴⁷ Sam Swenson, *What's the Most Tax-Friendly Way to Hold Bitcoin?*, THE MOTLEY FOOL (Oct. 15, 2021), <https://www.fool.com/investing/2021/10/15/whats-the-most-tax-friendly-way-to-hold-bitcoin/> (listing pros and cons of different types of accounts).

¹⁴⁸ *Id.*

¹⁴⁹ Tynisa Gaines, *Crypto Wash Sale Rule: 2024 IRS Rules*, TokenTax (Updated Apr. 1, 2024), <https://tokentax.co/blog/wash-sale-trading-in-crypto>.

¹⁵⁰ See 26 U.S.C. § 1091.

¹⁵¹ Under current law, the wash sale rule applies only to securities and not crypto assets. Gaines, *supra* note 149.

¹⁵² *Id.*; see Muskaan Aggarwal, *Cryptocurrency Regulation in the US in 2023*, LEGAMART (Mar. 6, 2023), <https://legamart.com/articles/cryptocurrency-regulation-in-the-us-in-2023/> (“The Build Back Better Act 2021 does contain

one's tax liability by reducing capital gains, this loophole may eventually be closed.

9. Use of domestic 'crypto hubs.'

The treatment of virtual currencies by state regulations is not uniform.¹⁵³ The lack of uniform regulation has resulted in some states becoming far more crypto-friendly than others.¹⁵⁴ A crypto-friendly state can have significant advantages for clients, including potential tax savings and a favorable regulatory environment. For example, a state such as Florida, which has emerged as a hub for crypto investors and crypto businesses, offers several benefits.¹⁵⁵ First, Florida does not feature a state income tax, which can result in significant tax savings for individuals with large cryptocurrency holdings.¹⁵⁶ Further, Florida recently enacted legislation that eases restrictions on the state's crypto industry.¹⁵⁷ And despite fluctuations in the crypto market and the FTX fallout, the state has several high-profile politicians who remain bullish on crypto's future in the state, including Republican Governor Ron DeSantis, who urged

language capable of making the wash sale rule applicable to cryptocurrencies. However, the Act has failed to pass the U.S. Senate, and hence, the loophole still exists.”).

¹⁵³ Carlton Fields, *State Regulations on Virtual Currency and Blockchain Technologies*, Apr. 9, 2021, <https://www.carltonfields.com/insights/publications/2021/state-regulations-virtual-currency-blockchain-tech>; Carol Kokinis-Graves and Max Traphagan, *Cryptocurrency and State Legislation: The Current State of Crypto State Taxes in 2023*, WOLTERS KLUWER Jan. 27, 2023), <https://www.wolterskluwer.com/en/expert-insights/cryptocurrency-and-state-legislation-the-current-state-of-crypto-state-taxes-in-2023>.

¹⁵⁴ See Jaime B. Herren, *Let's Talk Cryptocurrencies and 'Digital Assets': A Primer for Trust and Estate Lawyers*, HOLLAND & KNIGHT (June 24, 2022), <https://www.lexology.com/library/detail.aspx?g=8c9f3998-83ad-4394-81a1-4cc805e04c2a> (“Some jurisdictions are more crypto-friendly than others.”).

¹⁵⁵ Miles Brooks, *6 Crypto-Friendly States in 2023: Tax Benefits & More*, COINLEDGER, <https://coinledger.io/blog/crypto-friendly-states> (listing Florida among one of “the best states for cryptocurrency taxes”).

¹⁵⁶ FLA. STAT. § 220.02 (2023) (“No income tax [is] levied upon natural persons who are residents and citizens of this state.”).

¹⁵⁷ Fla. Sess. Law Serv. Ch. 2022-113 (C.S.H.B. 273); Daniel T. Stabile, Kimberly A. Prior, and Dhruva Krishna, *Florida Governor Signs Legislation Easing Cryptocurrency Regulation*, WINSTON & STRAWN (May 20, 2022), <https://www.winston.com/en/blogs-and-podcasts/non-fungible-insights-blockchain-decrypted/florida-governor-signs-legislation-easing-cryptocurrency-regulation> (“The legislation amends Florida’s financial regulations targeting money service businesses (MSBs), creates a new definition for ‘virtual currency,’ and ultimately eases restrictions on Florida’s crypto industry.”).

Florida's legislature to allow businesses to pay taxes using crypto,¹⁵⁸ and Miami Mayor Francis Suarez (R), who declared Miami the "crypto capital of the world."¹⁵⁹

Similarly, Colorado has passed legislation to allow cryptocurrency as payment for taxes,¹⁶⁰ and there are ongoing legislative efforts in Arizona and California that would see bitcoin accepted as legal tender in those states.¹⁶¹ Conversely, the few states that have enacted comprehensive regulations have resulted in crypto businesses leaving to escape the restrictive regulatory framework.¹⁶² Therefore, estate planners should conduct thorough research and analysis of the regulatory environment of each state before advising clients to relocate or invest in cryptocurrency in that state.

¹⁵⁸ Sebastian Sinclair, *DeSantis Says Florida 'Should Be Willing' to Accept Taxes in Crypto*, BLOCKWORKS (Mar. 23, 2022), <https://blockworks.co/news/desantis-says-florida-should-be-willing-to-accept-taxes-in-crypto>.

¹⁵⁹ Mayor Francis Suarez (@FrancisSuarez), Twitter (Jun. 11, 2021, 1:44 PM), <https://twitter.com/FrancisSuarez/status/1403407851477999616>; see also Joey Flechas and Vinod Sreeharsha, *MiamiCoin Trading Halted After Price Tanked, Mayor Francis Suarez Lost About \$2,500*, YAHOO! FINANCE (Mar. 22, 2023), <https://news.yahoo.com/miamicoin-trading-halted-price-tanked-000604446.html>; Aila Slisco, *Miami Passes Resolution to Allow Paying City Workers in Bitcoin in Attempt to Woo Big Tech*, NEWSWEEK (Feb. 11, 2021), <https://www.newsweek.com/miami-passes-resolution-allow-paying-city-workers-bitcoin-attempt-woo-big-tech-1568784>.

¹⁶⁰ Eric Fayeulle, *Colorado to Become the First State to Accept Cryptocurrency as Payment for Taxes*, ABC NEWS (Feb. 23, 2022), <https://abcnews.go.com/ABCNews/colorado-state-accept-cryptocurrency-payment-taxes/story?id=83066842#:~:text=Interest%20Successfully%20Added-,Colorado%20to%20become%20the%20first%20state%20to%20accept%20cryptocurrency%20as,plan%20on%20social%20media%20Thursday.&text=Colorado%20will%20become%20the%20first,Governor%20Jared%20Polis%20announced%20Wednesday>.

¹⁶¹ BTCCasey, *Arizona Senator Introduces Bill to Make Bitcoin Legal Tender in the State*, BITCOIN MAGAZINE (Jan. 25, 2023), <https://www.coindesk.com/business/2022/01/28/arizona-senator-introduces-bill-to-make-bitcoin-legal-tender/>; CryptoAI, *California Becomes Latest U.S. State Considering Bitcoin as Legal Tender*, MEDIUM (Feb. 22, 2022), <https://medium.com/coinmonks/california-becomes-latest-u-s-state-considering-bitcoin-as-legal-tender-e3441df30e16>; S. 1275, 117th Congress.

¹⁶² Carlton Fields, *supra* note 153. ("The few states that have attempted to enact comprehensive regulations, including New York's much maligned 'BitLicense' scheme, has resulted in an exodus of blockchain and virtual currency businesses from states attempting to treat all virtual currency operators identically with traditional money transmitters that are better equipped to deal with an overly restrictive regulatory framework.").

V. CROSS-BORDER ESTATE PLANNING

Cryptocurrency regulation varies greatly depending on the jurisdiction, and some estates may be subject to multiple jurisdictions' tax laws. Thus, cross-border estate planning involving cryptocurrency adds complexity and requires a comprehensive understanding of the tax implications in different jurisdictions.

A. Favorable Jurisdictions, Offshore Accounts

Foreign tax treatment of cryptocurrency is a complex and evolving issue with countries taking vastly different approaches to the regulation and taxation of crypto.¹⁶³ The lack of clarity and consistency in regulations across countries has resulted in a fragmented regulatory landscape. The differences in cryptocurrency treatment have created tax-favorable jurisdictions that may be a tax-planning consideration for clients with considerable cryptocurrency holdings.

One potential benefit of living in a tax-favorable jurisdiction or using offshore accounts for crypto tax planning is the ability to reduce or eliminate taxes on gains from cryptocurrency investments.¹⁶⁴ In some jurisdictions, taxes on capital gains from cryptocurrency can be high, so relocating is one way to reduce those taxes. Further, some jurisdictions provide greater privacy and confidentiality, which may be attractive to some investors.¹⁶⁵

Individuals who own cryptocurrency in multiple countries may also want to consider relocating to a jurisdiction that provides mechanisms to avoid double taxation. For example, some jurisdictions offer a credit for taxes paid in another country, helping to offset double taxation.¹⁶⁶ Further, some countries have bilateral tax treaties or agreements that affect the taxation of assets held by individuals with connections to both countries.¹⁶⁷ These treaties may affect reporting requirements, influence

¹⁶³ For example, countries such as the United States, the United Kingdom, Australia, and Singapore classify crypto as property, while Canada treats it as a commodity. Thomson Reuters, "Cryptocurrency Regulations by Country" (2022).

¹⁶⁴ Manoj Singh, *Tax Havens: All You Need to Know*, INVESTOPEDIA (July 19, 2022), <https://www.investopedia.com/articles/tax/09/tax-havens.asp>.

¹⁶⁵ *Id.*

¹⁶⁶ See generally I.R.S., *Foreign Tax Credit* (Nov. 3, 2023), <https://www.irs.gov/individuals/international-taxpayers/foreign-tax-credit>.

¹⁶⁷ Michael A. Heimos, *Non-Citizens - Estate, Gift, and Generation-Skipping Transfer Taxation*, 837-4th Tax Mgmt. Port., Section IV.G. For example, the United States and the United Kingdom have a tax treaty designed to mitigate double taxation and ensure proper reporting in both jurisdictions. See Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With

how cryptocurrency assets are taxed, provide exemptions, and mitigate double taxation.¹⁶⁸

Puerto Rico is an example of a popular crypto hub that many taxpayers have relocated to for the territory's favorable tax treatment.¹⁶⁹ In addition to having a lower cost of living and beautiful weather, Puerto Rico does not tax capital gains, making it a popular destination for cryptocurrency investors looking to reduce their tax burden.¹⁷⁰ Other tax-favorable destinations include Switzerland, Malaysia, and the Cayman Islands — all of which provide zero tax on gains from cryptocurrency.¹⁷¹

However, while relocating to tax-favorable jurisdictions and using offshore accounts provide some benefits, they also carry potential legal and ethical implications. It's important for estate planners to advise their clients on the process of establishing bona fide residency in another jurisdiction and to work with qualified tax and legal professionals to ensure compliance with that jurisdiction's tax laws. For example, to take advantage of Puerto Rico's tax incentives, individuals must establish bona fide residency in Puerto Rico.¹⁷² This requires meeting several requirements, including spending at least 183 days a year in Puerto Rico; obtaining a driver's license and registering to vote in Puerto Rico; and establishing community ties on the island, such as joining local organizations or clubs.¹⁷³

B. Situs and Tangibility

In many jurisdictions, including the United States, situs determines the jurisdiction or location where an asset is deemed to be located or situated for legal and tax purposes.¹⁷⁴ The concept of situs is

Respect to Taxes on Income and on Capital Gains, U.K.-U.S. (July 24, 2001).

¹⁶⁸ Heimos, *supra* note 167.

¹⁶⁹ Daniel Kuhn, *Living in Puerto Rico, Where the Taxes Are Low and Crypto Thrives*, COINDESK (Feb. 9, 2023), <https://finance.yahoo.com/news/living-puerto-rico-where-taxes-130000119.html> ("Relocating to Puerto Rico to avoid taxes is simpatico with crypto's goals.").

¹⁷⁰ *Id.* ("Though it is officially a part of the U.S., the island has cordoned itself off from the mainland's tax code and exempts residents from taxes on capital gains.").

¹⁷¹ Global Citizen Solutions, *Ten Crypto Tax Haven Countries: A Guide For Savvy Investors*, Sept. 8, 2023, <https://www.globalcitizensolutions.com/crypto-tax-haven/>.

¹⁷² Travis Lyk, *Top Tax Havens Around the World*, PRELOCATE (Feb. 16, 2023).

¹⁷³ *Id.*

¹⁷⁴ See, e.g., *Safe Deposit and Tr. Co. of Balt. v. Commonwealth of Va.*, 280 U.S. 83, 92 (1929); Elizabeth Nicholls and Catherine Pugsley, "Demystifying the Situs of Crypto Assets for the Crypto Curious," LEE BOLTON MONIER WILLIAMS, <https://www.lbmw.com/site/services/personal/wills-trusts-probate/private-client->

primarily relevant in the context of cross-border estate planning and transfers of property.¹⁷⁵ Because cryptocurrency is a digital asset, determining its situs can be somewhat complex and is not clearly defined in the tax code or regulations.¹⁷⁶

Situs determinations can have major legal and tax consequences, particularly for non-U.S. citizens or residents. In the U.S., the federal government imposes an estate tax on the worldwide assets of U.S. citizens and residents, regardless of where those assets are located.¹⁷⁷ So if a U.S. citizen owns assets overseas, their situs is irrelevant for federal estate tax purposes.¹⁷⁸ Conversely, non-U.S. persons are generally subject to U.S. estate tax only on assets that are situated or deemed situated in the United States at their death.¹⁷⁹

Situs determinations generally hinge on whether a particular asset is tangible or intangible.¹⁸⁰ Classification as a tangible or intangible asset also has major implications for gift tax liability. Specifically, while non-U.S. persons are subject to a gift tax on transfers of tangible, U.S.-situs assets,¹⁸¹ they are exempt from U.S. gift tax for gifts of intangible property, even if the property is a U.S.-situs asset.¹⁸²

Situs determinations for tangible assets are relatively straightforward. For example, cash is sited by physical location.¹⁸³ Thus, a nonresident alien typically incurs gift tax when giving cash within the

blog/demystifying-the-situs-of-crypto-assets-for-the-crypto-curious (undated) (discussing the importance of determining the situs and tangibility of cryptocurrency in the United Kingdom).

¹⁷⁵ For domestic transfers of property within a single country or jurisdiction, the concept of situs may be less relevant. *Curry v. McCannless*, 307 U.S. 357, 363 (1939) (noting that although individual states may have different tax laws, “the Fourteenth Amendment precludes the taxation of any interest in the same intangible in more than one state”).

¹⁷⁶ Anthony Diosdi, *The 2023 Tax Guide For Cryptocurrency and NFTs*, SF TAX COUNSEL (Apr. 12, 2023), <https://sftaxcounsel.com/tax-guide-for-cryptocurrency-and-nfts/> (“The IRS has yet to provide guidance on how to determine the situs of cryptocurrency for estate and gift tax purposes, or whether cryptocurrencies are tangible or intangible property for such purposes.”).

¹⁷⁷ 26 U.S.C. § 2031(a).

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ Ajay Gupta, *Bitcoin: Currency or Property; Tangible or Intangible?*, 80 TAX NOTES INT’L 384 (2015) (“The situs rules turn on whether the particular asset is tangible or intangible.”).

¹⁸¹ 26 U.S.C. § 2501(a)(1); IRS, “Gift Tax for Nonresidents Not Citizens of the United States” (Jan. 25, 2023).

¹⁸² 26 U.S.C. § 2501(a)(2).

¹⁸³ 26 C.F.R. § 25.2511-3(b)(1).

U.S., whereas no gift tax is applicable if the same cash gift is made abroad.¹⁸⁴ Conversely, intangible assets, such as stocks and bonds held in a trust, are not sited by a physical location but rather are based on personal jurisdiction.¹⁸⁵ As a result, transfers from the bank account of an NRA, regardless of its location, escape liability from gift tax.¹⁸⁶

Although the IRS has not directly addressed whether cryptocurrency falls into the category of tangible or intangible property, the prevailing view — demonstrated by precedent¹⁸⁷ and state law¹⁸⁸ — is that cryptocurrency is intangible because of its digital nature.¹⁸⁹ This aligns with the broader concept of intangible property.¹⁹⁰ Further, the Financial Accounting Standards Board has released an Accounting Standards Update that clarifies crypto assets as meeting the U.S. Generally

¹⁸⁴ Gupta, *supra* note 180.

¹⁸⁵ *Curry*, 307 U.S. at 371 (holding the situs of intangible assets was the jurisdiction where the decedent had power to dispose of the assets).

¹⁸⁶ Gupta, *supra* note 180.

¹⁸⁷ *See, e.g., In re Celsius Network LLC*, 647 B.R. 631, 657 (Bankr. S.D.N.Y. 2023) (categorizing cryptocurrency as intangible property); *Ox Labs Inc. v. BitPay Inc.*, 848 Fed. Appx. 795, 796 (9th Cir. 2021) (finding the same); and *Burt v. Travelers Commercial Insurance Co.*, 621 F. Supp. 3d 1049, 1052 (N.D. Cal. 2022) (same).

¹⁸⁸ New York State Department of Taxation and Finance, “Tax Department Policy on Transactions Using Convertible Virtual Currency,” Technical Memorandum TSB-M-14(5)C, (7)I, (17)S (Dec. 5, 2014) (classifying crypto as intangible property for tax purposes in New York). Conversely, no state or federal agency has classified cryptocurrency as tangible property. *See* Casey W. Baker, Thomas Norton, and Ralph E. McKinney, *U.S. State Taxation of Cryptocurrency-Involved Transactions: Trends and Considerations for Policy Makers*, 75 TAX LAW. 601, 627 (2022) (“All states that have spoken on virtual currency follow the federal treatment of virtual currency (i.e., it is not a currency but rather intangible personal property).”).

¹⁸⁹ Baker, Norton, and McKinney, *supra* note 188, at 628 (“Because of its digital nature, cryptocurrency — to the extent considered property — is generally considered intangible property.”); *see also* Matt E. Kirk, *Planning for the Future: Estate and Tax Planning With Digital Assets*, HOLLAND & KNIGHT (June 10, 2022), <https://www.hklaw.com/en/insights/publications/2022/06/planning-for-the-future-estate-and-tax-planning-with-digital-assets> (“Digital assets are intangible personal property under current law.”).

¹⁹⁰ *See* International Financial Reporting Standards Interpretation Committee, “Holdings of Cryptocurrencies — June 2019” (“Paragraph 8 of IAS 38, Intangible Assets defines an intangible asset as ‘an identifiable non-monetary asset without physical substance.’”); Will Kenton, *Intangible Personal Property: Definition, Types, and Example*, INVESTOPEDIA (Apr. 30, 2022), <https://www.investopedia.com/terms/i/intangible-personal-property.asp#:~:text=Intangible%20personal%20property%20is%20anything%20with%20no%20obvious%20and%20assigned,%2C%20social%2C%20or%20reputational%20capital> (“Intangible personal property refers to an item of value that cannot be touched or physically held.”).

Accepted Accounting Principles' definition of an intangible asset.¹⁹¹ And the International Financial Reporting Interpretations Committee classifies cryptocurrency as an intangible asset under International Accounting Standards.¹⁹²

VI. CONCLUSION

Cryptocurrency is a rapidly evolving area of estate planning and the challenges associated with it are likely to persist as more individuals acquire cryptocurrency assets. Despite these challenges, there are ways that estate planners can help their clients protect their cryptocurrency assets and pass them on to their heirs in a tax-efficient manner. Estate planners can provide valuable advice to their clients by staying up to date with the latest developments in cryptocurrency taxation and regulation. They can also work closely with tax professionals to ensure that their clients' cryptocurrency assets are properly accounted for and included in their estate plans. Also, they can recommend that their clients establish clear instructions for the transfer of their digital assets to their heirs. Further, estate planners must be wary of the added complexities of cross-border estate planning with cryptocurrency. With proper planning and guidance, estate planners can help their clients navigate the complexities of cryptocurrency estate planning and ensure that their digital assets are protected for future generations.

¹⁹¹ FASB, *Accounting for and Disclosure of Crypto Assets*, (final ASU forthcoming by the end of 2023) (last updated Sept. 14, 2023), <https://www.fasb.org/page/PageContent?pageId=/projects/recentlycompleted/accounting-for-and-disclosure-of-crypto-assets.html>.

¹⁹² IFRS, *supra* note 190 (determining that cryptocurrency may be classified as an "intangible asset in IAS 38 on the grounds that (a) it is capable of being separated from the holder and sold or transferred individually; and (b) it does not give the holder a right to receive a fixed or determinable number of units of currency.").