Estate Planning and Administration in the Digital Age

By Timothy M. Ferges*

Timothy M. Ferges examines estate planning and administration in the digital age.

As estate planners and tax advisors, when we think of estate planning and administration, certain assets come to mind. We typically think of real estate, vehicles, jewelry, and other tangible personal property. We might also think of financial assets, such as cash, stocks, and bonds. Those assets may have value—from both an economic and tax perspective. Other assets of an estate, such as photographs, may be limited to sentimental value.

In recent years, a great deal of our property has been replaced by digital assets. Our photographs, music collections, and written correspondence have been replaced by digital pictures, online music collections, and emails, respectively. Other assets that still exist in traditional form are now controlled through a digital format. For example, we are now maintaining bank accounts on the Internet. We are even investing in financial assets that exist only in their electronic form, such as cryptocurrencies.

A whole virtual estate may now exist upon a decedent's death. Therefore, it has become increasingly important to plan for the administration of these assets. Many jurisdictions have recognized the prominence of digital assets among estate property. They are adopting legislation allowing fiduciaries access to these assets so those fiduciaries can manage or distribute those assets in accordance with the decedent's intent. That access, however, requires careful planning. When planning for digital assets, we must also address traditional estate planning concerns, including the minimization of income and transfer taxes as well as asset protection.

Fiduciary Access to Digital Assets

It is the legal obligation of the personal representative, *i.e.*, the executor of the decedent's will or the administrator of her intestate estate, to marshal all estate assets, pay creditors (including the taxation authorities), and then distribute estate assets to the decedent's heirs or beneficiaries under her will. That obligation is no different when it comes to digital assets. The process, however, can become quite complicated when the decedent owned digital assets.

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A "digital asset" has been defined as "an electronic record in which an individual has a right or interest."[1] Typically, a digital asset will not include an underlying asset or liability "unless the asset or liability is itself an electronic record."[2] In other words, while an online account on a bank's website is a digital asset, the cash deposited in a bank account accessed through that online account is not in itself a digital asset. On the other hand, a cryptocurrency, an electronic form of currency which has value that exists only electronically, is itself a digital asset (in addition to the online account on which it is maintained).

Many jurisdictions have recognized the prominence of digital assets among estate property. They are adopting legislation allowing fiduciaries access to these assets so those fiduciaries can manage or distribute those assets in accordance with the decedent's intent.

In order to inventory and collect digital assets, the personal representative must deal with online providers that often impose terms of service agreements or policies that greatly vary. Those agreements and policies may impose a significant roadblock that can impede the fiduciary's efforts.

Digital assets are often maintained on password protected websites. Users may have a multitude of accounts each with a different password. Unless some designated person can access a decedent's accounts, they may be lost forever along with the information stored on those websites. A decedent's family may also desire to remove a social media account or delete other online information. Without the ability to access the decedent's digital assets, this may not be possible.

To address these concerns, the Uniform Law Commission has adopted the Revised Uniform Fiduciary Access to Digital Assets Act (the "RUFADAA"),[3] a model law that has been rapidly adopted in many states. As of February 2018, 37 states had adopted some form of the RUFADAA, with seven additional states and the District of Columbia having introduced the model law into legislature for adoption.[4]

The purpose of the RUFADAA is to allow fiduciaries to manage digital assets in the same manner they manage the decedent's tangible property and traditional financial assets.[5] The act also grants the "custodian"[6] of a digital asset (*i.e.*, the service that maintains the digital asset) legal authority to deal with fiduciaries who seek to manage those assets after the user's death.[7]

Under the Act, the "user" (*i.e.*, the individual who maintains the digital asset) can now direct the custodian to disclose or not to disclose to a designated recipient some or all of the user's digital assets, including the content of electronic communications.[8] This direction can be effectuated through either an online tool provided by the custodian or *via* an estate planning instrument, such as a will, trust, or power of attorney instrument.[9] Moreover, the act allows a user to grant a fiduciary access to the user's communications—either to a "catalogue" of those communications or to their substantive content.[10]

The custodian is then obligated to comply with the fiduciary's request for either disclosure of the digital asset or for access or termination of an account.[11] If the custodian refuses to comply, the fiduciary may apply for a court order directing such compliance.[12] Thus if appointed by the user, a fiduciary, such as an executor, trustee, or agent under a power of attorney, can now manage a digital asset as directed by the user in her estate planning documents.

While the RUFADAA allows the fiduciary the right to manage a digital asset, it does not, on its own, grant the fiduciary the right to dispose the asset. Typically that right is defined under the custodian's "Terms of Service" agreement (the lengthy agreement we see when we register to use a website). While a user could own a digital asset, those terms may instead provide that information uploaded or shared to the website is owned by the custodian or perhaps that the digital asset is licensed to the user.[13]

By granting a fiduciary the power to access the digital asset, the fiduciary can exercise the same power over the information that the user could have. This can be crucial from an estate administration perspective. To the extent the asset is transferrable, the fiduciary can take control of the asset, manage it, and ultimately dispose it in accordance with the decedent's expressed desire. The fiduciary also has the power to alter information uploaded on the Internet.

Moreover, allowing a fiduciary access to digital assets can assist the fiduciary with her identification of other assets of the estate—both digital and nondigital. For example, with proper planning, a decedent can allow a fiduciary access to the content of her electronic communications. The decedent's emails might reveal electronic bank statements leading to discovery of financial assets that could

otherwise be unknown. The decedent's emails might also reveal that the decedent engaged in cryptocurrency or other electronic transactions.

Therefore, in this digital age, planning and providing for fiduciary access to digital assets is an essential component of an estate plan.

The Duties and Obligations of a Fiduciary With Respect to Digital Assets

To the extent a personal representative is granted authority to access, manage or distribute digital assets, she should consider her fiduciary obligations in connection with that authority. In general, the estate representative has the power to receive assets, manage those assets, satisfy debts and claims, dispose assets and to make distributions.[14]

This power comes with a great deal of responsibility. Under the Uniform Probate Code (which has been adopted in many states), the duties of a personal representative "commence upon his appointment."[15] Those duties, which are also owed by trustees, include the duties of due care, loyalty, good faith, confidentiality, among other duties. Under the RUFADAA, a user of a digital asset is now recognized to have a property right that asset,[16] and those strict duties and obligations owed by estate personal representatives and trustees are now extended to the actions of a fiduciary accessing digital assets.[17]

The RUFADAA imposes specific limitations with respect to the fiduciary's administration of an estate's digital assets. Thus, for example, the fiduciary would not be authorized to publish the decedent's confidential communications or impersonate[18] the decedent by sending email from the decedent's account. The fiduciary's management of digital assets may also be limited by other applicable law.[19] For example, a fiduciary may not copy or distribute digital files in violation of copyright law.[20]

Whether the estate representative has the power to receive, manage, dispose or distribute a digital asset will depend on the user's own rights with respect to that asset. For example, if the rights to the asset terminates upon death, the personal representative will not have authority to administer the asset.[21] The extent of the user's rights with respect to that asset—and by extension the right of his or her fiduciary to manage the asset after death—will likely depend on the provisions of the Terms of Service agreement.

To the extent the estate continues to hold a beneficial ownership interest in digital assets of the decedent after death, the personal representative will need to inventory and determine those assets. That process will be necessary in the event the fiduciary is obligated to account to heirs, beneficiaries or creditors for her administration of the estate. Such an inventory will also be necessary to the extent the estate is subject to federal or state estate tax.

Like any traditional asset, the fiduciary will have a duty to safeguard the estate's digital assets. It is imperative that the fiduciary protect the decedent's computers, smartphones, and other hardware devices on which digital assets or passwords may be stored. Certain traditional means of safeguarding assets, such as the use of safe deposit boxes and other physical security measures, however, will not protect digital assets that do not exist in physical form.

In order to inventory and collect digital assets, the personal representative must deal with online providers that often impose terms of service agreements or policies that greatly vary. Those agreements and policies may impose a significant roadblock that can impede the fiduciary's efforts.

Digital assets could be misappropriated or damaged through hacking. For example, Coinrail, a South Korean cryptocurrency exchange, was recently targeted by hackers who stole about 30% of the virtual currencies traded on that exchange.[22] A personal representative will need to consider the risk that the estate's digital assets could likewise be targeted by hackers or subject to other security threats that could subject the fiduciary to liability if there is resulting harm to the estate or its assets. The fiduciary will need to take whatever measures are available to safeguard those assets and minimize that risk.

Transfer Tax Implications of Digital Assets in Estate Planning

Like traditional assets, the law of most jurisdictions now recognizes that a user of a digital asset has a property

right in that asset.[23] Pursuant to Code Sec. 2033 and Reg. §20.2033-1(a), a decedent's gross estate includes the value of all property—whether tangible or intangible—which the decedent beneficially owned upon her death.[24] Thus, to the extent digital assets have monetary value, lifetime and testamentary transfers of those assets may be subject to estate, gift or generation-skipping transfer tax.[25] Such digital assets owned by a decedent would need to be reported on an estate or gift tax return just as traditional assets with value are reported.

Accordingly, pursuant to Code Sec. 2031(a) and Reg. §20.2031-1(b), to the extent a digital asset has ascertainable economic value, its fair market value must generally be determined at the date of the user's death.[26] This fair market value would be determined by considering its value in an arm's-length transaction between a willing buyer and a willing seller.[27]

When advising clients, estate planners and tax advisors should expand their planning focus from traditional assets to include digital assets. It is important that advisors become familiar with digital assets, how they are accessed, and the property rights associated with those assets upon the user's death.

How does one determine whether a digital asset has ascertainable value? If a digital asset produces income or can be exchanged for value and if it can be gratuitously transferred by a decedent, it is subject to transfer taxes and should be included in the decedent's gross estate.[28]

Cryptocurrencies, which can be traded like traditional securities or commodities, may come to mind as a digital asset with economic value. Electronic intellectual property such as a domain name, commercial website, or a blog that generates advertisement or subscription fees could have quantifiable economic value—albeit, that value may be affected by the blogger's death.[29] The unpublished work of a well-known writer existing only in electronic form could certainly have value. A decedent might have even invested in virtual real estate, a new digital asset that can be traded or sold for value.[30]

Other digital assets, such as digital photographs, likely have only sentimental value. Social media accounts maintained with Facebook, LinkedIn and the like may have little to no economic value to the extent the provider prohibits commercial use by the user.[31]

On the other hand, some assets that would typically fall in the strictly "sentimental" category, could, under certain circumstances, have economic value. For example, the email account of a celebrity or other public figure could conceivably be a valuable asset.[32]

Some digital accounts may not be inherently valuable. For example, the income generated by a user's account may be attributable to the underlying assets themselves rather than the digital account on which the assets are maintained. Thus as the account itself may not independently be a source of revenue, it may be determined that the user's account does not have its own economic value.[33]

For example, craigslist, ebay and similar accounts allow a user to buy and sell a wide variety of property. Economic value may be limited to the underlying assets maintained by the user through those accounts. Likewise, underlying securities maintained on one's etrade account would have value, but the user's etrade account itself may not.

As with traditional assets, if an estate subject to federal or state estate tax owns digital assets determined to have economic value, the fiduciary should inventory those digital assets and determine their value. Digital assets could conceivably be subject to valuation discounts for lack of marketability or control. If necessary, the assets should be valued by a qualified appraiser, and they should be specifically identified on the estate tax return.

Like other investments, some digital assets with value, such as cryptocurrencies, are subject to market fluctuations.[34] If those digital assets depreciate in value after the decedent's death, the estate representative can elect to use the alternate valuation date—six months after the decedent's death—to value the digital asset and thus reduce estate taxes.[35]

Income Tax Implications of Digital Assets in Estate Planning

Digital assets, like traditional assets with value, may have appreciated in value by the decedent's death. Those assets may have large built-in capital gains. As with traditional assets held at death, digital assets with economic value can benefit from a step-up in basis equal to the fair market value of those assets as of the date of death.[36]

Some assets, such as domain names or commercial websites created by the decedent could have a relatively small basis or perhaps no basis at all. Thus to the extent

the asset has become valuable, the basis-step up can potentially eliminate substantial federal and state income tax that would have been owed had the asset been disposed during the owner's lifetime.

There have been past questions regarding whether cryptocurrency would be treated, for tax purposes, as property subject to capital gains tax or instead simply as currency. Some suggested cryptocurrency should be treated, for tax purposes, as a form of currency—like U.S. dollars or euros—rather than as a capital asset.

In response to perceived potential for tax evasion using cryptocurrencies, in March 2014, the IRS issued guidance regarding taxation of cryptocurrencies. In Notice 2014-21, it clarified that while cryptocurrency can be used to pay for goods and services, "general tax principles applicable to property transactions apply to transactions using virtual currency."[37] Like stocks, bonds, other securities, and commodities, to the extent a cryptocurrency is a capital asset, it will be subject to capital gain or loss upon its disposition.[38] Thus upon the owner's death, cryptocurrencies, like other digital assets of value, can receive a basis-step up (or step down) to fair market value.

Of course, as with other assets, it is the burden of the taxpayer to determine the fair market value of the decedent's digital assets. Moreover, to the extent a federal estate tax return is filed, the heir who inherits a digital asset is thereafter subject to the basis consistency rules under Code Sec. 1014(f).[39]

Specific Estate Planning Considerations Regarding Digital Assets

As digital assets represent an increasingly large portion of many estates, it is imperative that clients incorporate planning for those assets in their estate plans. The same estate planning goals used with traditional assets should be applied to digital assets. Estate planners should plan for the disposition of these assets—to the extent possible in a tax-efficient manner that also offers creditor protection.

To the extent the user's jurisdiction has adopted the RUFADAA or a similar law, and the user does not wish to leave access to her digital accounts subject to a Terms of Service agreement, she should direct, in her will, trust or power of attorney instrument that the custodian provide her fiduciary access to her accounts.[40]

As digital assets become a larger portion of a decedent's property, some estate planners have advocated for an inter vivos mechanism to manage those assets, such as a "digital[41] asset protection trust" (or a "DAP Trust").[42] The grantor of the trust would place his or her digital property rights into a revocable DAP Trust.[43] As licenses to digital assets often expire upon the user's death, this strategy has been proposed to allow for the continued management and transfer of those licenses.[44]

Unlike a Will, which is publicly filed with a court, a revocable trust, like a DAP Trust, would not become a public record. Therefore proponents of the use of such a trust have emphasized the trust could serve as a secure mechanism for the grantor to record his or her passwords to various digital accounts or other access information, such as the "private key" needed to access and take possession of cryptocurrency.[45] Another approach to provide a fiduciary with passwords and other access information in a discrete manner is to reference in a will a list that would separately disclose that information—in the same manner that a will can make reference to a list of tangible personal property.[46]

On the other hand, to the extent a user desires that an account not be accessed by a fiduciary after her death, it may be good practice to make this clear in her estate planning documents to avoid any question regarding the user's intent. If the user desires that the fiduciary close or terminate a digital account or asset, that direction should be likewise stated in the estate planning documents, perhaps with exculpatory language that would protect the fiduciary in the event such action is challenged.[47]

As with other assets, a good estate planning strategy may warrant consideration of the adjusted basis of valuable digital assets. Under the Tax Cuts and Jobs Act, the federal estate tax exemption has doubled from $5 million indexed for inflation to $10 million indexed for inflation (as of 2018, the exemption is $11.18 million per person). Thus an individual can currently transfer $11.18 million in assets through a combination of lifetime and at death transfers free of estate, gift, and generation-skipping transfer tax. If the individual is married, the individual and his or her spouse can make lifetime and at death transfers that together double that amount free of transfer tax.

In recent years, many states have eliminated[48] their estate tax or also greatly increased their state estate tax exemption. Therefore the great majority of estates are no longer subject to federal estate tax and many are also not subject to state estate tax.

For many, this has shifted the focus of estate planning from the reduction of estate taxes to the minimization of income taxes. An owner's retention of a low-basis digital asset upon her death, such as a commercial website or a domain name created by the owner herself, can benefit from

a potential substantial basis step up. The owner's retention of such a digital asset may be a powerful estate planning strategy. If the owner wishes to now make a gift of a low-basis digital asset, the owner may choose to make a gift to a revocable trust as assets transferred to a revocable trust will still benefit from a basis step-up upon the owner's death.

Otherwise, to the extent the owner wishes to make inter vivos gifts, it may be advisable for the owner to consider gifting high-basis digital assets as opposed to lower basis assets. For example, an owner may decide to make a lifetime gift of a cryptocurrency that is subject to market fluctuations to hedge the risk that its value may depreciate at death.

Conclusion

When advising clients, estate planners and tax advisors should expand their planning focus from traditional assets to include digital assets. It is important that advisors become familiar with digital assets, how they are accessed, and the property rights associated with those assets upon the user's death. In order to plan and implement a complete and thorough estate plan, advisors should inquire about their clients' digital presence and evaluate how to address those assets in a manner that incorporates tax planning and asset protection, while also carrying out their clients' intent.

ENDNOTES

* Timothy M. Ferges represents clients in complex litigation matters involving estates, trusts, and fiduciaries. He also focuses his practice on estate planning and trust and estate administration matters.

1 Rev. Unif. Fiduciary Access to Digital Assets Act §2(10).

2 *Id.*

3 *See* Rev. Unif. Fiduciary Access to Digital Assets Act prefatory note (Unif. Law Comm'n 2015).

4 Orzeske, Benjamin, *Probate & Property—Uniform Laws Update* (January/February 2018).

5 Rev. Unif. Fiduciary Access to Digital Assets Act prefatory note (Unif. Law Comm'n 2015).

6 *Id* at §4(a).

7 *Id.*

8 *Id* at §4(a).

9 *Id* at §4.

10 *Id* at §§7–13.

11 *Id* at §16.

12 *Id.*

13 Rev. Unif. Fiduciary Access to Digital Assets Act §15(f).

14 Unif. Probate Code at §3-715.

15 Unif. Probate Code at §3-701.

16 Rev. Unif. Fiduciary Access to Digital Assets Act prefatory note (Unif. Law Comm'n 2015).

17 Rev. Unif. Fiduciary Access to Digital Assets Act at §15(a).

18 *Id* at §15(b).

19 *Id.*

20 *Id.*

21 *Hoops*, Frederick K, et al., *Family Estate Planning Guide* §34:19 (4th ed.).

22 Shane, Daniel, *Billions in Cryptocurrency Wealth Wiped Out After Attack*, CNN Money, June 11, 2018, *http://money.cnn.com/2018/06/11/investing/coinrail-hack-bitcoin-exchange/index.html*.

23 *See, e.g.*, Rev. Unif. Fiduciary Access to Digital Assets Act prefatory note (Unif. Law Comm'n 2015).

24 Code Sec. 2033; Reg. §20.2033-1(a).

25 Code Sec. 2033 ("the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death"); Code Sec. 2512(a) ("if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift").

26 Code Sec. 2031(a) ("The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated"); Reg. §20.2031-1(b) ("The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section.").

27 Reg. §20.2031-1(b) ("The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.").

28 *Hoops*, Frederick K, et al., *Family Estate Planning Guide* §34:19 (4th ed.).

29 *Id.*

30 Russo, Camila, *Making a Killing in Virtual Real Estate*, Bloomberg Businessweek, June 12, 2018 (*www.bloomberg.com/news/articles/2018-06-12/making-a-killing-in-virtual-real-estate*).

31 *Hoops*, Frederick K, et al., *Family Estate Planning Guide* §34:19 (4th ed.).

32 *Id.*

33 *Id.*

34 *See, e.g.*, Bitcoin Valuation Charts at *https://charts.bitcoin.com/*.

35 Code Sec. 2032(a).

36 Code Sec. 1014(a).

37 *See* IRS Notice 2014-21, 2014-16 IRB 938.

38 *Id.*

39 Code Sec. 1014(f).

40 *Id* at §4.

41 A *digital* asset protection trust is not to be confused with a *domestic* asset protection trust (also commonly referred to as a "DAP Trust" or "DAPT"). The purpose of a *domestic* asset protection trust is creditor protection.

42 Beyer, Gerry W., *When You Pass on, Don't Leave the Passwords Behind: Planning for Digital Assets*, American Bar Association Probate & Property, 26(1), January/February 2012, at 40.

43 *See e.g., id*; David M. Goldman, "DAP Trusts," *www.jacksonvillelawyer.pro/dap-trust-digital-asset-trust.html*.

44 *Id.*

45 *Id.*

46 *Hoops*, Frederick K, et al., *Family Estate Planning Guide* §34:19 (4th ed.); *see* Unif. Probate Code at §2-513.

47 *Blachly*, Victoria, *Planning for Fiduciary Access to Digital Assets*, American Bar Association Probate & Property Magazine, 29(5).

48 For example, New Jersey recently eliminated its estate tax.