

Digital Assets and Smart Contracts: What Advisers Need to Know Now

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by Tasha K. Dickinson and
Leigh E. Furtado

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Although the rise of NFTs has been most noticeable in the art, music and sports industries, the underlying smart contract technology and reliance on the blockchain could extend to a variety of legal and financial transactions in the near future. It is possible that titles to houses, contacts and perhaps even estate planning documents could eventually be tracked via blockchain technology. Even now there are concepts which advisers should discuss with clients to ensure any planning

involves a comprehensive understanding of the client's asset picture and goals.

Intake Questionnaires: It is imperative that advisers start asking their clients whether they own or are considering investing in cryptocurrencies, NFTs or other emerging digital assets. Just as clients sometimes do not think of life insurance as a part of their taxable estate, they may not recognize the need to disclose digital assets. References to digital assets in all estate plan documents will need to be updated as these asset classes evolve and should be drafted broadly to incorporate emerging technologies. The Florida Fiduciaries Access to Digital Assets Act must be referenced in the estate plan documents, but those statutory provisions should be considered a floor—not a ceiling—in terms of granting comprehensive powers to fiduciaries to manage digital assets.



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Tasha K. Dickinson, left, and Leigh E. Furtado, right, of Day Pitney.

Privacy and Security: Advisers must emphasize the importance of both protecting valuable assets and ensuring that fiduciaries can actually access and transfer those assets after the client's death. The decentralized nature of blockchain technology poses some unique challenges. Fiduciaries first need to be aware that the client owns cryptocurrencies or digital assets, know on which exchange or application such assets are held, and understand personal keys and seed

phrases, where applicable. At the same time, that combination of information would make it possible to irrevocably transfer the asset away from the client during his or her lifetime. Practitioners can certainly envision scenarios where choosing the wrong fiduciary or the presence of undue influence could be disastrous.

Choosing the Best Fiduciaries: Great care should be given to selecting fiduciaries who are knowledgeable about digital assets and blockchain technology and who are capable of managing such assets. It may even be advisable to name a separate “digital fiduciary” who is tasked only with transferring digital assets. Alternatively, clients might consider directing their fiduciaries to seek the advice of a trusted, tech-savvy adviser who is specifically named in the estate plan documents. Consideration should also be given to explicitly authorizing trustees to retain NFTs or cryptocurrencies, despite the fact that many states have enacted prudent investor rules. In the absence of specific authorization, a trustee may be obligated to sell the token or crypto assets and reinvest the proceeds in order to diversify a trust portfolio or reduce risk.

Tax Planning and LLC Opportunities: As these technologies evolve, clients may be interested in gifting digital assets through more sophisticated planning techniques. Holding an NFT or other digital

asset in a limited liability company (LLC) may provide for the efficient management of the entity’s underlying asset while allowing the client to retain some control over its sale and management (subject to certain limitations if tax planning is a concern). The client can also name an appropriate successor manager who is knowledgeable about the applicable asset category. Transfer of ownership may be simplified because members can sell, gift or transfer membership interests in the LLC, rather than having to go back to the blockchain for each transfer or transferring control of the token. This allows for the centralized management of the NFT or other digital asset, despite the fact that the economic interests can be spread across multiple parties. They can also leverage their gift/estate and generation-skipping transfer tax exemptions and minimize transfer taxes when gifting LLC interests by applying discounts due to minority ownership and/or lack of marketability. The novelty and volatile nature of digital assets could support substantial valuation discounts. An LLC can also be used for asset protection purposes—either to protect the members from the company’s liabilities or even to protect the underlying digital asset from the reach of the members’ creditors.

Future of Smart Contracts: In simplistic terms, a smart contract is a software program

that automates the generation of contract terms and formalizes the execution and enforcement of an agreement. Smart contracts are often embedded in blockchain platforms, and as changes are made, blocks are added to the blockchain and the digital ledger is distributed to every member of the blockchain network. This reduces the risk of hacking, since all the distributed copies would need to be altered to successfully disrupt the record. Blockchain technology can thus be used for peer-to-peer transfers of digital assets, for storing and validating digital records (like titles or stock certificates) and for generating and executing smart contracts. At this point, smart contract technology is more developed for repetitive commercial agreements, but the expansion of this technology is something advisers should monitor.

We are in a period of rapid change impacting the ownership classifications, valuations and regulatory guidance governing digital assets and cryptocurrencies. The future of smart contracts seems both inevitable and unpredictable. Protective guardrails need to be in place to preserve client assets and ensure a flexible but reasonable succession plan.

Tasha K. Dickinson is a trusts and estates partner based in the Day Pitney’s West Palm Beach office, and **Leigh E. Furtado** is a trusts and estates senior associate based in the firm’s Providence, R.I. office.