Why U.S. Crypto-Millionaires Should Undertake their Estate Planning and Create Irrevocable Trusts During this Crypto Market Downturn

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Cryptocurrencies, such as Bitcoin (BTC) and Ether (ETH), and non-fungible tokens (collectively "Crypto"), in 2022 were down over 70% from their all-time high in 2021. Although this decline is significant, Crypto investors (hodlers especially) will be quick to point out such declines have happened several times before. As everyone knows, in the United States, there are two certainties—death and taxes. For many Crypto investors, there is a third—Crypto will exceed its last all-time high in the next bull run. This article addresses all three certainties and how Crypto-millionaires or high-net-worth Crypto investors can capitalize from an estate planning perspective while Crypto prices are relatively low. This article primarily concerns individuals with high-net-worth that is composed of Crypto in substantial part.

Estate planning is the process whereby an individual legally formalizes who receives their assets, when, and how. While the individual is alive, this is usually done by outright gifts or lifetime gifts in trust for beneficiaries. At the individual's death, this may be by a will and/or testamentary trust (formed upon one's death). For high-net-worth Crypto investors, comprehensive estate planning goals should include minimization of gift taxes, estate taxes, generation-skipping transfer taxes, and income taxes, as well as maximizing asset protection, protection of private keys and passwords, and determining and effectuating desired bequests.

U.S. Gift and Estate and GST Taxes

In the United States, upon an individual's death, the federal estate tax is imposed on the estate of an individual whose net worth, plus lifetime taxable gifts, exceeds the lifetime unified gift and estate tax exclusion (the "Unified Exclusion," which Section 2010 refers to as the Basic Exclusion Amount). The Unified Exclusion fluctuates based on legislation and inflation. As of 2023, the Unified Exclusion per individual is $12,920,000—the highest in its history. However, it is scheduled to be reduced by half in 2026 under current law.

The federal gift tax applies when an individual gifts (outright or in trust) throughout life cumulatively more than the Unified Exclusion. The purpose of the gift tax is to ensure that individuals do not avoid the estate tax by gifting away their assets before they pass away; therefore, every individual has one Unified Exclusion for both gift and estate taxes. Further, an individual's lifetime gifts will reduce the remaining Unified Exclusion that will apply upon death. When a gift or estate tax applies, the Federal tax rate is generally 40% of the value of the transfer. Usually,

when an individual transfers an asset that is subject to the gift tax, that asset will not also be subject to estate tax in the individual's estate upon death.

Federal gift and estate taxes in their modern format have existed for approximately 100 years in the United States (the estate tax has existed since 1797 in an older format). In those 100 years, the federal estate (but not gift) tax was repealed only once, in 2010. Notably, about 13 states have their own estate taxes and exclusions that operate independently from the federal regime. For instance, for those dying residents of New York, its top marginal estate tax rate is 16%, and the state estate exclusion is $6,580,000 as of 2023.

Notably, another five states have an inheritance tax that generally is imposed on the recipient of the bequest unlike the estate tax. The inheritance tax is beyond the scope of this article.

There is also the federal Generation Skipping Transfer (GST) Tax that generally applies, in addition to gift and estate taxes, when an individual makes direct gifts or gifts in trust[1] to "skip persons." Skip persons are generally grandchildren or other persons who are two or more generations younger than the grantor individual. Largely, the purpose of the GST tax is to ensure that individuals do not avoid or skip the estate tax in their child's estate, by gifting to their grandchildren. Thus, the federal GST tax and gift or estate tax (less deductions) may apply to the same lifetime gift, or transfer at death, to a skip person. The GST tax exemption and tax rate are equivalent to those of federal gift and estate taxes—$12,920,000 and 40%. GST tax specifics are beyond the scope of this article.

The following focuses on minimizing gift and estate taxes via irrevocable trusts.

Irrevocable Trusts

An "Irrevocable Trust" is a legal arrangement whereby an individual (*i.e.*, trust creator or grantor) transfers assets to a trustee. The trustee takes legal ownership of and administers the assets for the benefit of the grantor's chosen beneficiaries upon the terms of the trust. Although there are many types of Irrevocable Trusts, their defining characteristic is that generally they cannot be revoked (*i.e.*, terminated) or amended by the grantor – meaning the grantor cannot unilaterally return the trust's assets back to the grantor. A properly structured Irrevocable Trust allows an individual to minimize gift/estate taxes, provides asset protection, and even achieve state income tax benefits. Irrevocably gifting Crypto to an Irrevocable Trust allows the grantor to lock in the current historically high Unified Exclusion before it halves in 2026.

Importantly, gifting Crypto to an Irrevocable Trust also enables the grantor to lock in a gift tax value while Crypto prices are low; this means that the years or decades of growth in Crypto while in a properly structured Irrevocable Trust will not be subject to any estate tax upon the grantor's

[1] The GST tax exemption is allocated to gifts in trust that are for or in the future may be for skip persons. When the allocated GST tax exemption is sufficient to exempt the entire gift, the trust is fully GST tax exempt, *i.e.*, future trust distributions and terminations will be exempt from the GST tax. When the grantor has no GST tax exemption remaining or the allocated GST tax exemption is not sufficient to exempt the entire gift, future trust "taxable distributions" or "taxable terminations" will be subject to the GST tax. IRC §§ 2621 & 2622. At that time, the GST tax will generally be based on the "inclusion ratio" (which is based on the amount of GST exemption allocated to the trust upon gift).

death. These assets can also escape estate tax upon the later death of grantor's primary beneficiaries, since a well-structured Irrevocable Trust may last for many decades, or even forever.[2]

Many high-net-worth Crypto investors may be interested in protecting their assets from creditors via an Irrevocable Trust. Successful asset protection means that the Crypto within the Irrevocable Trust generally will not be reachable in lawsuits or divorce/separation proceedings against the grantor or the beneficiaries of the Irrevocable Trust. The grantor's creditors generally have two to four years (*i.e.*, the statute of limitations period) to pursue any assets the grantor transfers to the Irrevocable Trust. When the grantor had a creditor pre-existing the trust, the statute of limitations period may be extended in court, if the creditor could not have discovered the creation of the Irrevocable Trust. The outcome of any claim may be highly dependent on the trust's state of residence and corresponding state law – as may be determined unfavorably by a court against an Irrevocable Trust that was improperly structured and/or administered.

For individuals residing in high-income tax states, properly formed Irrevocable Trusts can provide state income tax savings. The Irrevocable Trust should be formed in a zero-income tax state. This would permit Crypto capital gains (and certain other income) within the Trust to escape state income taxes that would otherwise apply in the individual's high-income tax state. To do this, the Irrevocable Trust must have some connection to the non-taxing state; this connection could be through the trustee's state of residency. To fulfill this requirement, an individual may appoint a Trust company, with offices in a zero-income tax state, to serve as an administrative trustee.

In response, the vast majority of high-net-worth Crypto investors in the United States might say, "I have way less than the Unified Exclusion in Crypto and other assets, so the Irrevocable Trust is not for me" (Situation 1). The fortunate few may respond, "I have enough or more assets than the Unified Exclusion, so I'm curious how this applies to me" (Situation 2). However, in both situations, Crypto investors will often say, "I am not ready to give away any Crypto to anyone else [Access Issue], and I do not want someone else [*i.e.*, the trustee] to invest and trade my Crypto [Control Issue]." These Situations and Issues are addressed below in a general manner. There are countless other factual and legal considerations that are beyond the scope of this article.

Situation 1

Individual has $1 million in Crypto, the entire net worth. The individual is 28 years old, unmarried, without children. Assume that the individual dies unmarried years in the future when: the Federal Unified Exclusion is $10 million and estate tax rate is 40%; the applicable state exemption is also $10 million, with the state estate tax rate at 10%, and federal and state estate tax deductions not considered. At this time, Crypto has gone up 22x from the current price. Assume that in consideration of the individual's expenditures and other income throughout the years, they have $20 million in Crypto remaining at their death.

[2] Certain states, such as SD and PA, do not have rules against perpetuities periods, thereby allowing trusts in those states to exist in perpetuity.

If the individual did no or minimal estate planning, then the estate tax liability would be approximately $5 million—that is, $20 million Crypto less the $10 million Unified Exclusion, times the 50% combined federal/state estate tax rate. Generally, the estate would have to pay the $5 million to the IRS and the state within nine months of the individual's death. Administration and distribution of the $15 million Crypto ($20 million Crypto less $5 million estate taxes) would likely be under the supervision of a probate court. This process can impose a delay of several months when the beneficiaries will receive their Crypto and can also result in expensive probate and legal fees.

If the individual creates an Irrevocable Trust and transfers the entire $1 million in Crypto to the Irrevocable Trust during this Crypto downturn, that $20 million in Crypto at the individual's death would be subject to zero gift/estate taxes. The transfer into Trust would be exempt from the gift tax because it is below the current Federal Unified Exclusion (it would still be necessary to file a federal gift tax return, Form 709, to report the gift). Upon the individual's death, the entire $20 million (less relatively nominal trust administration fees) may be distributed outright or in further trust to/for the individual's beneficiaries without any delay or expense of probate court.

Situation 2 - $15 Million in Crypto

Individual has $15 million in Crypto, which composes their entire net worth. The individual is 51 years old, not married and has children. Assume that the individual dies married sometime in the future when: the Unified Exclusion is $7.5 million; no state gift or estate tax rate applies, and federal and state estate tax deductions are not considered. At this time, Crypto has increased ninefold from the current price. Assume that in consideration of expenditures and other income throughout the years, upon death the individual has $120 million in Crypto remaining, which constitutes the combined net worth of the individual and the spouse. For simplicity, assume that the spouse dies shortly after the individual.

If the individual did no or minimal estate planning, then the combined estate tax liabilities of the estates would be $42 million; that is, $120 million less the $15 million in combined Unified Exclusions, times the 40% federal estate tax rate. Generally, each estate tax liability would be due to the IRS within nine months of the applicable spouse's death. The GST tax may also apply, generally, if any bequest is to a grandchild or other skip person. Distribution of the $78 million Crypto ($120 million less $42 million estate taxes) would likely be subject to supervision and months delay of two probate court actions (one for each spouse).

If the individual sets up an Irrevocable Trust for the $15 million during this Crypto downturn, with some additional planning that $120 million in Crypto would be subject to no estate taxes when the spouses die. In this situation, it would be advisable for the individual to set up a Limited Liability Company or Limited Partnership ("Family Entity") and fund that entity with the $15 million in Crypto. This would allow the individual to take advantage of gift tax valuation discounts that apply for minority ownership and marketability; generally, the IRS approves of such discounts combined to be approximately 30%. Thus, instead of transferring the $15 million directly into Trust, the individual would transfer that Crypto to a Family Entity. Then, the individual would gift minority and/or non-voting interests in the Family Entity to one or more Irrevocable Trusts. The discounted

value of that gift would be approximately $10.5 million. As such, the gift would be exempt from the Federal gift tax because it is below the current Unified Exclusion of $12.92 million. The GST Tax would also not apply.

The entire $120 million (less relatively nominal trust administration fees) may be distributed outright or in further trust to the individual's beneficiaries upon the individual's death, without any delay of two probate court actions (one for each spouse).

Access Issue

When many think of the term Irrevocable Trust, they think that they are parting with their assets; however, this does not need to be the case. Although most states deny asset protection to grantors of self-settled Irrevocable Trusts – that grantors set up for the benefit of themselves – some states permit such Trusts (often referred to as Domestic Asset Protection Trusts, or "DAPTs"). For example, Nevada and South Dakota permit self-settled Irrevocable Trusts and also happen to be zero-income tax states.

Essentially, as a beneficiary, the individual may receive distributions from the Trust under two types of discretionary standards. First, any trustee (who may be a family member) other than the individual, may distribute under the ascertainable standard of "health, education, maintenance, or support" of the individual. The individual can request and receive such distributions in the trustee's discretion. Second, an independent trustee (*e.g.*, trust company or professional) can make purely discretionary distributions of any amount under given circumstances. For instance, if the individual wants to start a business, the individual can request and, subject to the independent trustee's discretion, receive a large amount (*e.g.*, $2 million) from the Trust. Note: doing so would bring the distributed amount (or the business) into the individual's estate for estate tax purposes.

Alternatively, in virtually all states, a grantor can create an Irrevocable Spousal Lifetime Access Trust (SLAT) for the benefit of the grantor's spouse. This permits the grantor to retain indirect access to the SLAT's assets while the grantor's spouse maintains direct assets to the assets—all while gaining creditor protection and reducing the value of their taxable estate at death.

Control Issue

Most individuals, especially those who have been very successful with their Crypto holdings, generally do not want a random trustee to manage (*i.e.*, trade and invest) their holdings. With a DAPT formed in a self-settled trust jurisdiction such as Nevada, Delaware or South Dakota, this does not have to be the case. In those states, the individual can appoint a Trust company to be the administrative trustee and/or benefits trustee/advisor, while appointing him/herself to be the investment trustee/advisor. As such, the individual remains in control of how the Crypto is traded and invested.

Alternatively, or in addition, the individual may create a Family Entity and appoint him/herself as manager, before gifting the Family Entity interest to the Irrevocable Trust. The Family Entity would be the owner of the Crypto; as manager, the individual would be free to trade and invest the Crypto.

With respect to a SLAT, the individual can appoint their spouse and/or another as a trustee. This permits the grantor to retain indirect control over the SLAT's assets.

Also, a middle passage is possible. One can create an Irrevocable Trust for half or another part of their Crypto or Family Entity interest, while retaining individual ownership over the remaining part.

Step-Up in Basis (Section 1014)

Notably, setting up a DAPT or another type of Irrevocable Trust is not without downsides. The main downside to consider is that structuring such a Trust relinquishes the step-up in basis. Usually, the tax basis of an individual's assets is stepped-up to one's fair market value as of the date of the individual's death (or alternative valuation date) under section 1014. This is important because the capital gain tax applies to the excess of the sale price over the seller's tax basis in the Crypto. That excess is subject to long-term capital gain taxes at a combined Federal/state rate between 15% and 38%—depending on the seller's tax bracket and jurisdiction of residence—on Crypto or other property held over one year.

In Situation 1, with no or minimal estate planning, the individual's basis in Crypto would be stepped up to $20 million, at the individual's death. This means that the beneficiaries can immediately after receipt of their inheritance can sell the Crypto with no or minimal capital gains. The beneficiaries would avoid capital gain taxes that usually apply at a rate of between 15% and 38% (depending on their tax bracket and jurisdiction of residence), because their tax basis was recently stepped-up. Assuming a combined 30% capital gain rate and an original cost basis of $100,000, the saved capital gain taxes would be $4.47 million [($20 million – $5 million estate taxes – $100,000 cost basis) x 30%). Essentially, after estate taxes, the beneficiaries have $15 million (less administration expenses) that they can sell immediately without any capital gain taxes.

By comparison, in Situation 1, with an Irrevocable Trust, the individual's basis in Crypto would not be stepped up and would continue to be approximately $100,000 after death. However, the overwhelming benefit is that the Trust still holds approximately $20 million in Crypto because no estate taxes applied. The time value of not having to pay $5 million in estate taxes could be worth tens of millions in 20 to 30 years (depending on the rate of return). Further, the Trust can time when to sell the Crypto (and pay capital gain taxes) over several years or decades, whereas there is generally no opportunity to time estate taxes, which are due within 15 months after the individual's death.

Also, rather than sell Crypto, the Trust can distribute Crypto to the beneficiaries who would receive a transferred low basis. The beneficiaries can then time their Crypto dispositions and capital gain taxes over multiple years or decades. They can also take cash loans against the Crypto (via Maker or another protocol) tax free as long as the protocol does not liquidate the Crypto collateral.

Last, the GST Tax can definitively be avoided or minimized with an Irrevocable Trust, whereas no or minimal estate planning can lead to disastrous GST taxes for Crypto-millionaires.

In Closing

U.S.-based Crypto-millionaires and high-net-worth Crypto investors should not dismiss Irrevocable Trusts because it is too early or because they do not want to give up their Crypto. Given the enormous upside potential of Crypto, too much is at stake from a tax perspective. Such individuals can retain significant access to, and control over, their Crypto within a properly structured Irrevocable Trust and via the middle passage option, all the while achieving savings of millions of dollars in gift/estate taxes and state income taxes.

Disclaimer: This article is general in nature and does not consider the specifics of the reader's jurisdiction or circumstances; it does not constitute legal or tax advice. All references to sections are to those of the United States (US) Internal Revenue Code, as amended and currently in effect.

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