



CRYPTOCURRENCY & DIGITAL ASSETS

SEPTEMBER 2023

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BROWN BROTHERS HARRIMAN MULTI-FAMILY OFFICE & TRUST COMPANY

What are Digital Assets

- An electronic record in which an individual has a right or an interest. Digital assets do not include an underlying asset or liability unless the asset or liability is an electronic record.
- Electronic means anything relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.
- Digital assets do not include a computer, smartphone, or iPad. Digital assets are the pieces of information stored on a device such as digitally stored content, on-line account and electronic file storage.

Examples of Digital Assets

- ⦿ Electronic Documents
 - Files stored electronically on devices or cloud-based storage programs
- ⦿ Social Media Accounts
 - Facebook, LinkedIn, Instagram, Twitter
- ⦿ Financial Information/Financial Assets
 - Bitcoin, cryptocurrencies, Business Accounts
 - Websites, domain names, trademarks, cloud-based storage programs
- ⦿ Blogs, Podcasts, Pictures, Videos
- ⦿ Biometric Information and Identifiers

Impediments to Access

- ⦿ Terms of Service Agreements
- ⦿ Passwords and Encryption
- ⦿ Federal Laws
- ⦿ State Laws
- ⦿ LOTS of Ambiguity

What is Cryptocurrency?

- The first cryptocurrency – Bitcoin - was created in the wake of the 2008 financial crisis, by a posting of a position paper on a cryptography listserv.
- Instead of relying on a central trusted authority such as a bank, Bitcoin and other cryptocurrencies distribute financial/ownership information across a blockchain.
- A blockchain is a database or list of transactions that anyone can view and verify.
- Bitcoin is far from the only cryptocurrency in circulation— there are over 10,000 different cryptocurrencies in existence. Bitcoin remains the largest cryptocurrency by far, accounting for 46% of the total cryptocurrency value. Bitcoin's total market cap of is \$578 billion.

This stuff is volatile! Price of Bitcoin since inception

Bitcoin's Price History



Other Blockchain Digital Assets

- NFT: Non-Fungible Token. NFTs present many possible uses, but most commonly, today NFTs represent true ownership of real-world assets like digital artwork, music, tweets and even title to real estate. NFTs are bought and sold with cryptocurrency and encoded/live on the blockchain in the same way as cryptocurrency. In fact, NFTs are typically held on the Ethereum blockchain.
- Each NFT has a digital signature that makes it impossible to be exchanged for or equal to one another (hence, non-fungible).
- Smart contracts: digital contracts stored on a blockchain that are automatically executed when predetermined terms and conditions are met. NFTs use smartcontracts to manage ownership and transferability.

Other Blockchain Digital Assets

All digital assets are subject to potential fraud and grift, but the recent NFT craze seems to have provided a perfect opportunity for scam artists to take advantage of the newly created token market. Various NFT scams include:

- Rug Pulls
- Pump and Dumps
- Bidding Scams
- Plagiarism
- Artificial Inflation
- Air Drop Scams

What is a Wallet

- Tokens are stored in “wallets” that are uniquely identified with a public key and a private key
 - Public key is generally the “address” and is needed to transfer tokens to that wallet
 - Private key is the “password” of the wallet and is needed to transfer tokens from the wallet
 - Without the public key and the private key, tokens cannot be transferred
 - It is infeasible to break the cryptography securing the wallet
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- ◉ **Hot Wallet** – a wallet connected to the internet. Hot wallets are subject to hacking theft
 - ◉ **Cold Wallet** – a wallet that can’t be hacked because it is not connected to the internet. The address and private key are stored offline in a “hardware wallet” or paper form or otherwise

RUFADAA

- ◉ Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA) (2015)
 - Uniform law adopted by almost every state that establishes fiduciary rights to receive disclosure of, and access, digital assets (including cryptocurrency)
 - A fiduciary (such as a trustee or executor) has the right to receive access to digital assets held by custodians (such as an exchange)
 - Additional rules apply to digital assets that include the contents of electronic communications, but those are generally not relevant to cryptocurrency

RUFADAA Hierarchy

- On-line Tools
 - *Account specific* tools that provide directions for the disclosure of digital assets to a “designated recipient”
 - Only serve the purpose that the custodian defines them to serve
- Consent in Wills/Trusts
 - Testator may specifically provide lawful consent to the fiduciary
 - On-line Tools could diverge from consent in wills/trusts
- Terms of Service Agreements (“TOSAs”)
 - The TOSA may restrict access to the executor
 - The TOSA may delete the asset in its entirety

Income Tax Characterization of Crypto

- ◉ When cryptocurrency is acquired for services rendered such as mining, it is ordinary income to the acquirer at the moment of acquisition.
- ◉ In a ruling issued in March 2014 (Notice 2014-21), the IRS stated that virtual currencies will be treated as property according to U.S. tax law, incurring capital gains or losses when bought or sold.
- ◉ As with other property, different tax rates apply to sales and exchanges of cryptocurrency depending on the holding period of property prior to the exchange (short-term capital gains if less than a year; long-term capital gains if more than a year). As with other capital assets, crypto capital gains and losses are reported on Schedule D of IRS Form 1040.
- ◉ Furthermore, the IRS has ruled that even when used in transactions, the difference in U.S. dollar value in the cryptocurrency from the date of purchase to the date of use is also treated as a capital gain or loss.
- ◉ For example, if a taxpayer purchases Bitcoin for \$1,000 and then uses it to buy a new Tesla on a later date when the Bitcoin has appreciated to \$8,000, the exchange of Bitcoin for a Tesla triggers \$7,000 of capital gain, which is a recognition event for income tax purposes.

Income Tax Characterization of Crypto

- 2022 Form 1040 has question (slightly different from prior years) on first page: “At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?”
- The IRS continues to issue “John Doe” summonses to exchanges like Coinbase to determine what holders of substantial crypto are doing (see *e.g.*, *Coinbase, Inc.*, No. 17-cv-01431-JSC (N.D. Cal. 11/28/17) (order re petition to enforce IRS summons)).

Planning: Gifts of Crypto

- ⦿ Because of its volatility, cryptocurrency is a great asset for a GRAT. Optimal techniques for sophisticated estate planning with cryptocurrency are evolving.
- ⦿ Recommended method of transferring title to Crypto incident to gifting:
 - The transferee (i.e. the irrevocable gift trust) should obtain a wallet.
 - The crypto should be electronically sent to that wallet on whatever method is appropriate. For example, a cold wallet can be connected to the web and then the device can be directed to send the cryptocurrency to the transferee's wallet.
 - The donor should not just simply share the private keys/public keys with should be recorded formally through the blockchain. the transferee or simply transfer the cold wallet and password to the transferee.
- ⦿ Placing crypto into an LLC could make transfers of crypto much easier

Charitable Giving with Crypto

- Crypto can be a very attractive asset to donate to charity if the holder has a large, unrealized gain
- Crypto *acquired for investment purposes (i.e., not mined)* is treated like privately-held stock/property for donation purposes. Contributions of crypto to a *public charity* held for longer than one-year receive a full fair market value deduction.
- Substantial crypto holders are readily donating crypto to a donor advised fund or a charitable remainder trust
- Donations to charities not able to accept direct donations of crypto may still be possible through third-party processors
- For donations over \$500, donor must complete Form 8283, and for donations over \$5,000, donor must complete section B of Form 8283 and provide a qualified appraisal

Risks for Fiduciaries

- Fiduciary Risk: Estate planning documents should waive all duties expressly with respect to crypto holdings
- Cryptocurrency is a largely unregulated highly volatile asset class— and we don't know when, if and how regulation is coming
- Hacking is everywhere— and there is no/little insurance or recourse for hacked or lost crypto
- Have firm policies and protocol in place BEFORE you assume a fiduciary role.
- Update inventory and in-take forms and include specific asset types.

Anti-Money Laundering and Know Your Client Diligence

- If/when a holder sells substantial cryptocurrency and converts to fiat currency, the holder should be prepared for substantial anti-money laundering and know-your-client documentation requests from the bank into which the holder plans to deposit the fiat currency.
- Banking institutions are required to scrutinize the source of funds deposited into the government banking system. Because cryptocurrencies are designed to be held and exchanged anonymously, it is very difficult to prove that the holder's cryptocurrency originated from a legitimate source.

“All In” On Crypto? Practical Advice for Financial Professionals

- Many who have created wealth through cryptocurrency love keeping a heavily-concentrated position in cryptocurrency. They find the volatility fun!
- Your advice should be consistent with your firm’s best thinking about investing, including building a diversified portfolio and a reasonable reserve for the client’s support needs and other financial goals.
- There are many crypto entrepreneurs who were paper millionaires and billionaires.



ARTIFICIAL INTELLIGENCE

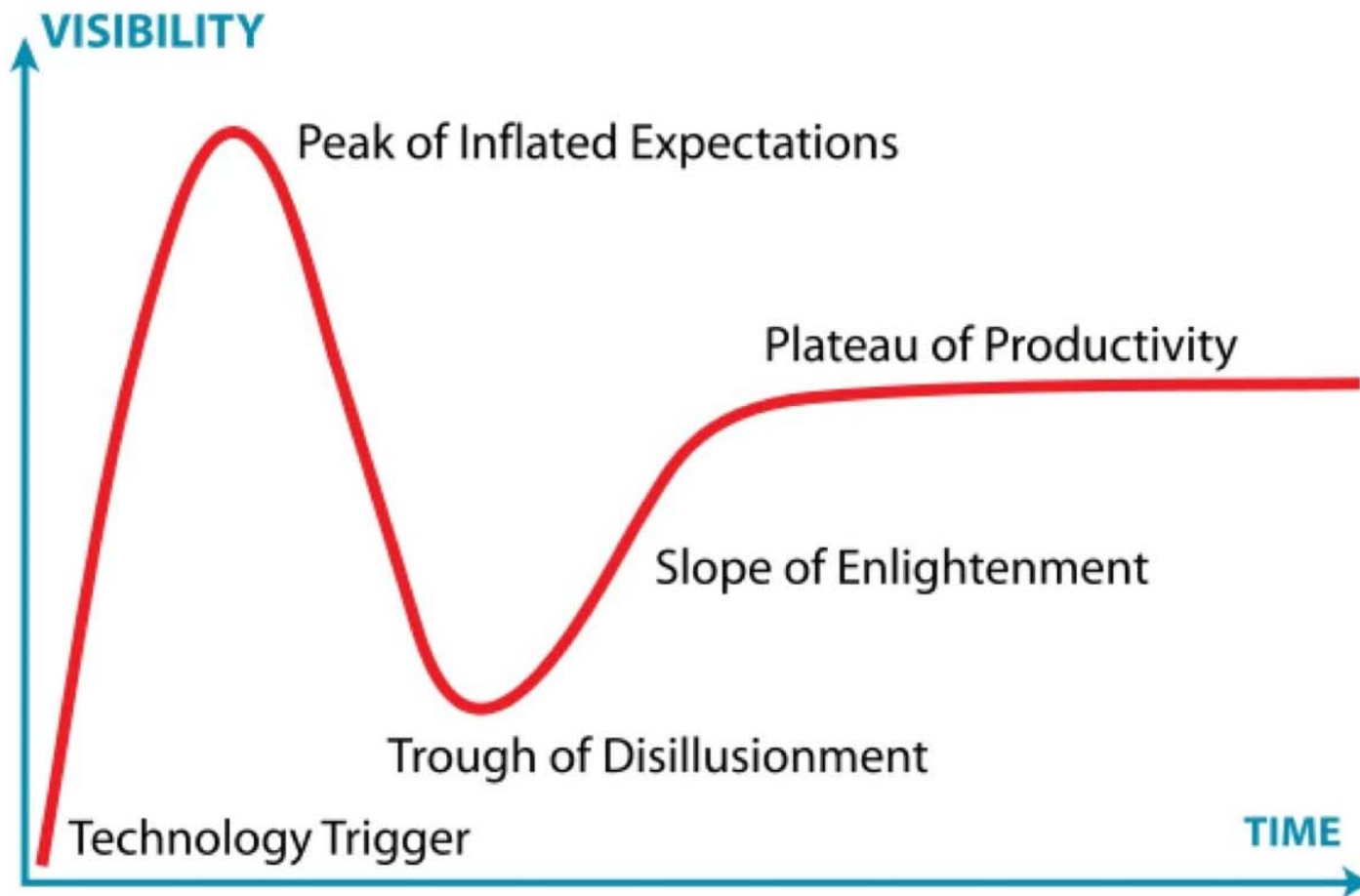
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**Over the Next Decade Artificial
Intelligence Will Become as
Fundamental to Our Professional
Lives as Email and the Internet Have
Been Over the Last Twenty-Five Years**

And yet . . .

Gartner Hype Cycle



What Lies Ahead for Artificial Intelligence?

Four Options

- ⦿ This is it. Artificial Intelligence (AI) never gets better
- ⦿ Slow gains in AI capability
- ⦿ Continued exponential improvements but no Artificial General Intelligence (AGI)
- ⦿ AGI

What is ChatGPT?

- ⦿ Created by OpenAI but has many competitors
- ⦿ The fastest-growing app of all time, reaching 100 million users in only two months
- ⦿ An AI chatbot built on a family of large language models (LLMs) - a computer algorithm that processes natural language inputs and predicts the next word based on what it's already seen; then it predicts the next word, and the next word, and so on until its answer is complete

What is ChatGPT?

- ⦿ GPT stands for Generative Pre-trained Transformer
- ⦿ Generative: Creates language
- ⦿ Pre-trained: Has been trained on huge amounts of text data to predict the next word in a given sequence
- ⦿ Transformer: A neural networks that learns context and understanding through sequential data analysis; originally designed by Google in 2017 for language translation
- ⦿ Older LLMs could not interpret large amounts of data at once, but with the right prompt ChatGPT can ...







ChatGPT in 2023

- ⦿ A tool that can understand intricacies of human languages will have nearly unlimited uses
- ⦿ Like having 100 mediocre interns working for you – but it can learn, never forgets, and never sleeps, eats, or quits
- ⦿ Lots of accuracy problems, but continuously improving
- ⦿ Learning to write good prompts is helpful, but ChatGPT is learning how to make better prompts
- ⦿ Code Interpreter - ChatGPT knows how to code
- ⦿ Students are learning with ChatGPT in mind

**6 More Predictions for How
*AI MAY Change The Practice of Law
Over the Next 10 Years***

We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction.

- Bill Gates

#1 – AI Will Inspire the Creation of Many More Document Drafting Programs – and Consumers Will (Mostly) Benefit

- ⦿ Document preparation tools were on the rise pre-GPT
- ⦿ AI will make content creation and drafting options easier for businesses to incorporate into forms – currently blocked by ChatGPT but restrictions will not last indefinitely
- ⦿ Difficult for attorneys to compete on marketing and price, but many will incorporate into their practice
- ⦿ Both professional and consumer-based products
- ⦿ At first will clog the market with error prone and lousy documents; will improve with time to be a superior product to human drafted forms

#2 – Chatbots Will Become a Common Feature for Many Areas of the Law

- ⦿ AI chatbots will be able to guide clients, attorneys, and other advisors through the legal decision-making process with the skill of an experienced attorney
- ⦿ Providers may also offer help to individuals make real time decisions in negotiations or in legal proceedings as well as help offer counter arguments in trial preparation - Donotpay.com example
- ⦿ Chatbots could offer non-legal administrative guidance in government offices and courts

#3 – AI Will Offer a Faster and Cheaper Method of Reading and Analyzing Documents

- ⦿ AI tools will be able to read documents more quickly and accurately than humans
- ⦿ Will be able to alert humans of errors and ambiguities within documents
- ⦿ They will be able to catalog the data, organize it, and present it clearly
- ⦿ Currently in very early stages of development

#4 –Relying Upon AI-Integrated Legal Research Platforms Will Become the Industry Standard

- ⦿ Research platforms such as Westlaw and LexisNexis will integrate AI into their search engines and analyses
- ⦿ Searches that used to take hours or days will be done in minutes or seconds
- ⦿ Learning to correctly prompt AI and maximize its capability will become one of the most valued research skills in the legal industry

#5 – Law Firms Will Need to Teach Staff How to Use AI – Junior Associates Will Become a Major Source of Innovation

- ⦿ Law firms will need to instruct support staff on using AI to conductive their jobs more efficiently
- ⦿ Education must be provided in a manner that does not alienate staff or threaten their job security
- ⦿ Law schools and their students are at the cutting edge of experimenting and exploring how to best use AI - recent graduates may offer better thinking around future use of AI

#6 – Personal Relationships Between Attorneys and Clients Remain Irreplaceable – but the Commoditization of the Practice Will Threaten the Industry as We Know it

- ⦿ A lack of a universally accepted definition of empathy makes it difficult to program into machines
- ⦿ Inherent bias is present in AI & machines are only as empathetic as the data they are trained on, which can be influenced by human biases and prejudices
- ⦿ Teaching AI empathy and understanding the complexities of human emotions presents an immense challenge
- ⦿ But convincing clients that legal work is more than just inputs and outputs will be a challenge



QUESTIONS??

ROSS.BRUCH@BBH.COM