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A Cryptocurrency Primer

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Cryptocurrency is a digital currency that is not issued or sponsored by a government. Instead, transactions are verified and records are maintained by a decentralized system using cryptography, also known as blockchain technology. Although initially viewed by some as part of the Wild West fringes of the internet, crypto is gaining traction and acceptance as a legitimate, albeit sometimes volatile, investment vehicle.

As examples of mainstream acceptance, Elon Musk announced that Tesla may start accepting Bitcoin as payment for the purchase of vehicles and PayPal allows users to buy and hold cryptocurrency in their digital wallets. BNY Mellon announced that it will hold, transfer and issue Bitcoin and other cryptocurrencies on behalf of its asset management clients. The BNY Mellon announcement eased the concerns many wealth managers had over the regulatory, legal and stability risks of directly managing cryptocurrencies.

While many financial planners consider cryptocurrency to be like investment fads of the past, it's difficult now to ignore crypto's impact.

About Sentinel Trust Company

Sentinel Trust Company, LBA is an independent wealth management firm and multi-family office that provides comprehensive wealth and succession planning, fiduciary, investment management, philanthropic, and family office services to a select group of affluent families and their closely held entities and foundations. Founded in 1997 as the successor to two 40-plus-year old single-family offices, Sentinel Trust currently serves more than 30 multi-generational families nationwide and is responsible for approximately $5 billion in assets as of December 31, 2020.

Learn more at
www.sentineltrust.com.

Cryptocurrency investing has been around for more than a decade and has exploded in reach and value in recent years. According to CoinMarketCap and Coindesk, the market value of cryptocurrency assets is hovering around $2.5 trillion.

An article late last year noted that, although major brokerages (e.g., Wells Fargo, JPMorgan Chase, Merrill Lynch and Morgan Stanley) have asked their advisors not to offer recommendations on cryptocurrency, Wells Fargo issues primers that advisors can share with clients. The Wealth Report Attitudes Survey of more than 600 bankers, advisors and family offices reveals that ultra-high net worth investors allocate on average about 1% of portfolio assets to cryptocurrency, but that figure is poised to increase. A 2021 Goldman Sachs survey discovered that 40% of clients own cryptocurrency, 61% expected their crypto assets to increase over the next 12-24 months and 57% thought the recent surge in cryptocurrency prices is related to availability of institutional product offerings.

Acquisition and Safekeeping

Cryptocurrencies can be purchased and held on exchanges like Coinbase, much like a brokerage account. Exchanges provide easy access to the owner, but potentially are subject to theft by hackers. So-called "wallets" can be more secure. "Cold" wallet storage refers to offline storage devices such as a USB drive, computer, tablet or scrap of paper that is not connected to the internet. Cold wallets are safe from hacking, but can be lost, stolen, or inadvertently destroyed. "Hot" wallets are online or desktop apps that allow you to store keys and passwords to access cryptocurrencies. These are potentially subject to loss by hacking or other external means. There is substantial literature available which outlines the pros and cons of each option.

Each cryptocurrency wallet is assigned a blockchain address that allows its owner to send and receive currency (often referred to as coins or tokens). The wallet is secured by a private, highly complex, and lengthy numeric key that must be input before any transaction can occur with respect to that wallet. Thus, unlike traditional assets, there is no personal identifying information associated with the crypto assets and the wallet can only be accessed through the private key. Loss of the key means the wallet's contents become forever inaccessible.

For traditional assets like real estate or stock brokerage accounts, there typically is a certificate or other legal document identifying the owner. By contrast, cryptocurrency networks are largely decentralized, meaning users conduct and police financial transactions within the system rather than through a centralized authority. The wallet and its key are, well, "key" to cryptocurrency ownership.

Stefan Thomas, a computer programmer, made headlines after a lost password rendered $220 million worth of his Bitcoin inaccessible. This mishap served as an important wake-up call to cryptocurrency holders, reinforcing the need to develop a plan to protect and pass on their digital assets.

Cryptocurrency custody solutions have grown in popularity as analysts and institutional investors increasingly view them as a bridge between the traditional institutional investment market and the shifting cryptocurrency space. At least two developments are expected to affect the future

of cryptocurrency custody. The first one is the entry of big players. Established names like Goldman Sachs are conspicuously absent from the list of major organizations offering cryptocurrency solutions. At this point, Coinbase and Fidelity Investments appear to be taking the lead in offering or designing cryptocurrency custody services. The second one is regulatory clarity about storage security and other aspects of cryptocurrencies. The industry will evolve only after regulators step in and set rules for the playing field. Recent clarifications from the Office of the Comptroller of the Currency have begun to provide some clarity, but more guidance is needed.

Transferring Crypto at Death

A recent online survey showed that 10% of people in the United States now own some form of cryptocurrency. Unfortunately, a 2020 survey by the Cremation Institute revealed that only 23% of 1,150 respondents reported having a documented plan for passing on their crypto assets at death. Despite the lack of planning, 89% of those survey respondents worry about whether their crypto assets will be passed on to their loved ones.

Bitcoin and other cryptocurrencies are entirely anonymous, so if the holder dies without communicating ownership or providing the corresponding password or private key, the cryptocurrency becomes inaccessible and “dies” too. The estate plan documents should outline how cryptocurrencies are to be distributed at death and provide the named fiduciary with authority and the powers to hold cryptocurrencies. The plan also should authorize fiduciaries to provide passwords to the beneficiaries when the assets are “distributed.” Great care should be taken to select a truly trusted trustee since the passwords and encryption codes are extremely sensitive. Owners also should address who will have the authority to deal with cryptocurrency during disability, and ensure that any power of attorney holder has the proper authority for this type of asset and the information to access the crypto accounts.

The most sensitive aspect of owning cryptocurrencies is that the person with the password (“key”) is the “owner.” Anyone with the key to the account can access the cryptocurrency and move it to some other location which the original owner cannot access. Therefore, advisors should not be given the password or key, and instead simply be familiar with password storage and be able to ensure a well-documented process whereby named fiduciaries can access the accounts.

Taxation

The IRS treats cryptocurrency as property, not as a currency. General income tax principles applicable to property transactions apply to virtual currency, and as such, cryptocurrency transactions have tax consequences, namely capital gains and losses. Consequently, owners must track cost basis and keep records to correctly report the gain or loss. Since this sale treatment applies not only to direct sales, but also to use of the crypto to purchase goods or services, the recordkeeping can become burdensome. Each block of currency will have its own income tax basis and holding period to determine whether capital gains/losses are short or long term. Owners should consult tax counsel for opportunities to select the specific coins or tokens that minimize gains or maximize loss deductions. Tax-free like-kind-exchange treatment (e.g., swapping Bitcoin for Ethereum) is not allowed, although there is the potential to defer taxation of substantial gains through reinvestment of proceeds in qualified opportunity zones.

Crypto can be used for charitable giving, but tax counsel should be consulted to select the best coins to maximize the deduction, as well as to determine required documentation (e.g., proof of fair market value and acknowledgement from the recipient organization).

Not surprisingly, lifetime gifts of cryptocurrencies are taxable gifts, but can be eligible for annual gift exclusions and the use of the lifetime gift exemption. Crypto owned at death is includible in the adjusted gross estate and is subject to estate tax (which may be sheltered by the estate tax exemption).

The increasing acceptance of cryptocurrencies as legitimate investment assets has created new complexities surrounding acquisition, ownership, transfer and taxation. Due to crypto’s unique digital existence, careful consideration must be given to ensuring they are not lost or stolen and that they remain accessible after the owner becomes incapacitated or passes away. The often high volatility gives rise to potentially substantial tax consequences that require significant recordkeeping and thoughtful planning. Coordination with your investment and tax professionals is a must. ■

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A Case for Investing in ENTITY MANAGEMENT

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President and Chief Executive Officer

Properly managing partnership, LLC, corporate and trust structures can be key to mitigating risk. If an entity's owners, managers, officers or trustees fail to respect the formalities of its structure and legal governance requirements, regulatory bodies, creditors and others may assert claims that could be extremely detrimental to the family and its business and financial interests.

For example, if you disrespect the formalities of a family limited partnership, the IRS and courts may not respect it either, potentially resulting in substantial additional gift and estate taxes. IRS has successfully challenged taxpayers who (mistakenly or otherwise) deposited the partnership's income into a partner's personal account; paid a partner's personal expenses from a partnership account; failed to hold and document partner meetings consistent with the partnership's purposes; and/or disregarded governing document provisions concerning distributions to partners.

So, proper entity management is important. It requires staying up-to-date on the fiduciary, regulatory and statutory responsibilities of a business entity and its stakeholders; assuring that the board and management are aware of and act appropriately on these governance matters; and actively maintaining and managing the corporate record to support all transactions, filings and audits to fulfill these responsibilities.

One aspect of entity management is the development and maintenance of accurate entity information, which is required for many business processes and planning transactions. **Examples include:**

- Opening investment and other financial accounts;
- Qualifying for tax benefits, such as valuation discounts upon the transfer of an entity interest by gift or upon death;
- Protecting stakeholders from personal liability for entity-level creditors and risks;
- Demonstrating and documenting the fairness and appropriateness of decisions that might be viewed by others as having been made in your own self-interest; and
- Providing safeguards to assure that formalities required for tax status are observed (e.g., compliance with payment dates for related-party promissory notes, capital account maintenance, etc.).

These actions can help enhance your entity management:

- **Assessment of current compliance status:** Review and catalog necessary entity documentation; analyze consistency and currency of documentation; and make remediation recommendations.
- **Entity compliance:** Document entity attributes (management structure, capital structure, ownership baseline information, etc.) for effective overall management. Track all legal jurisdictions, related filing deadlines and general entity housekeeping requirements.
- **Governance:** Create and maintain a comprehensive calendar of filing due dates and required meetings. Maintain meeting minutes, consents and resolutions to provide clear visibility into key legal, tax and financial decisions made by the entity's officers and managers for relevant stakeholders. ■

Acquiring PHYSICAL GOLD

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Head of Equities,
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Gold can diversify your portfolio, provide protection against inflation, and offer a store of value in uncertain times. Although many investors own gold indirectly through exchange traded funds like “SPDR Gold Shares (GLD),” others gain additional peace of mind from direct ownership of physical gold bullion, coins, or both. This article covers some of the considerations relevant to direct ownership of gold.

As a first step, we recommend that you work with your investment advisor to determine:

- ***What is your goal for holding physical gold?*** If you are seeking physical gold as a purely investment asset, 10-ounce gold bars can be an efficient way of acquiring that exposure. Alternatively, collector-quality coins from a variety of mints offer the potential for appreciation over and above the price of gold bullion due to scarcity and uniqueness of the coins. However, if your goal is to own an accepted medium of exchange beyond traditional currencies (e.g., disaster recovery situations), lower denominated coins (and even silver coins as a complement) can be a more efficient way to prepare for such eventualities.
- ***What is the appropriate overall target size of your gold position (often expressed as a percentage of the total investment portfolio)?*** Larger physical gold holdings will allow you to purchase larger individual quantities (e.g., multiple ounce coins or bars vs. smaller denominations), which reduces the expected premium to spot prices on most exchanges.
- ***Where do you plan to store the gold?*** Keeping the gold safe from theft obviously is important and the physical quantity affects your alternatives. A bank safety deposit box is an obvious choice, but will it be accessible if your objective is to use it as a spending medium in the event of a failure of traditional national currencies?

Evaluating a gold vendor is similar to selecting other types of organizations. Essentially, price, selection, and service are the primary factors that will determine a platform’s customer loyalty.

Pricing is determined by a premium over the spot-market price, and volume discounts typically are available. Premiums vary by provider and can impact the overall acquisition price significantly. Volume discounts are exactly what you’d assume – the larger the quantity of gold purchased, generally the lower your premium to spot prices will be.

Selection and inventory can be important. Because your goals are unique and possibly changing over time, identifying a single platform capable of providing multiple metals, various denominations, bullion and collector minting, and stable inventory levels is essential. There are many providers who compete on price, but the goal is to identify a provider that offers options as well as competitive pricing.

A dealer’s service and reputation obviously is important. Ideally, the dealer or platform should have a lengthy operating history and multiple delivery options available. The marketplace has pushed out unscrupulous actors in recent years and most remaining providers are generally reputable. However, some due diligence is important.

Physical gold can be an important investment asset if properly tailored to your specific concerns and objectives. Work with your investment advisor to determine the best approaches and dealers for your needs. ■

Sentinel Trust Company is a family-owned, multi-family office focusing on the unique needs of affluent families and their closely held companies and foundations. Sentinel Trust provides advice on investment, tax, and estate strategies, serves as corporate trustee, and provides lifestyle services with a personal touch.

Together, families prosper SM

Founded in 1997 as the successor to two established, investment-focused single family offices, Sentinel Trust offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office, and the in-house technical skills of independent planning and investment management firms.

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