

Asset Protection for Cryptocurrency

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S. Blake Harris, Esq. is the managing attorney at Blake Harris Law, where he assists clients with wills and trusts, asset protection, and various matters related to crypto assets. Blake has extensive knowledge and experience helping families plan for and manage the transfer of their assets. Blake has been named a "Rising Star" for 2020 by Super Lawyers Magazine and has also been quoted in numerous state-wide and national publications.



What is purpose of Asset Protection?

- Putting our clients in a better position to survive a lawsuit than they would have been otherwise.
- Not Asset Protection
    - Hiding (confidentiality is fine)
    - Evading or Avoiding Taxes
    - Means or Excuse to make Fraudulent Transfers

Why do we need asset protection?

Contingency Fees; 1964 Maine was the final state to give in

- Morris Eisen, aggressive attorneys
- Bribe witnesses, doctoring photos, manufacturing evidence

Attorney Advertising

- 1977 Arizona Law Firm advertises in the Arizona Republic
- Supreme Court allows under a freedom of speech argument

Fishing Expeditions

- Amending Claims allowed as of 1977
- Frivolous claims

Why do we need asset protection?

ABA 1969: No Frivolous Claims

1983 Model Rules: Allowed any claim if had a reason for change in the law, any reason you can think of can be a reason to sue

- The U.S. is the world's most litigious society
- More than 10 million lawsuits filed each year in the U.S.
  - More than 10,000 lawsuits filed per day
  - $200 Billion ordered to pay out in U.S. judgments each year

Lawsuit Facts

Average time to complete a lawsuit:	45 months
Average cost of an experienced defense lawyer:	$400 per hour
Average cost for expert testimony (per expert):	$5,000-$10,000
Average cost to defend BEFORE TRIAL:	$46,000
Average cost of a TRIAL:	$180,000
Average cost to SETTLE a claim:	$260,000
57% of all malpractice fees go toward paying attorneys	
43% of all insurance defense costs go toward claims that have NO MERIT	

How to Avoid a Lawsuit



Avoiding v. Winning a lawsuit



Alternative Dispute Resolution

Constitutionally permitted for employers

Encouraged for all business relationships

How to Avoid a Lawsuit

- Employee Handbook
  - Fastest Growing: Train and Reduce Liability
  - Point to Employee Handbook for rules not to discriminate based on race, religion, gender, etc.

How to Avoid a Lawsuit

- Well drafted contracts
  - Clients get excited, put in time, money, and energy
  - Some win, some lose
  - Goal: avoid litigation & part as friends
- Comply with industry or professional regulations

How to Avoid a Lawsuit

- Sign a Pre-Nuptial agreement
  - Number one Lawsuit
- Consider marriage consequences
    - Medicaid Availability
    - Estate Planning Considerations
  - Blended Families need to protect children
  - Few hours now, few years later
  - Spouses have lots of power
  - Not for traditional Asset Protection Planning

1

Don’t be flashy or reveal badges of success

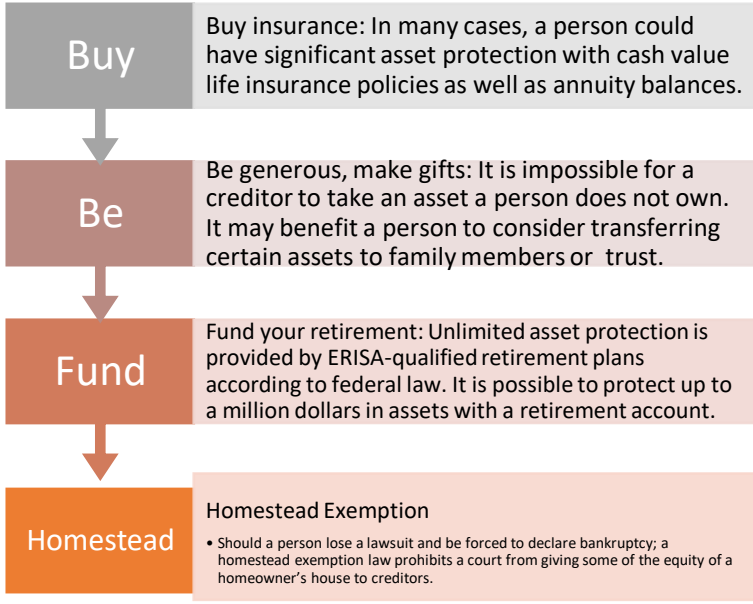
2

Show concern for your clients and employees

3

Seek out professional guidance

How to Avoid Paying a Lawsuit Judgment



Charging Order Protection

- When a plaintiff receives a Charging Order from an LLC or other entity, he has the right to receive all distributions made from that entity; but does not have the right to take anything else out.

Charging Order Protection

- So long as this creditor holds the Charging Order, the debtor can simply withhold distributions and pay themselves a salary for managing the LLC. Furthermore, the person who holds the Charging Order is responsible for the taxes levied on the LLC.

Charging Order Protection

- Once an attorney finds out that the only thing they can “win” is a Charging Order (on which they will probably receive nothing and still owe taxes), they are very likely to either drop the case or offer to settle.

Single Member Limited Liability Company

A single member LLC can reduce the liability associated with owning a certain asset. For example, real estate or heavy machinery should be owned by the LLC.

Several states amended their LLC laws to make it clear that SMLLCs are entitled to the same protection from creditors as multi-member LLCs. These include Delaware, Nevada, and Wyoming.

Must observe corporate formalities and filing requirements: Operating Agreement/Incorporation Documents, Articles of Incorporation

Multimember Limited Liability Company

- Multimember LLCs and Partnerships generally always provide Charging Order protection.
- Rationale is to protect the innocent partner(s) from a lawsuit against one of them.
- Husband and wife partnership is acceptable
- Can be gift, 50/50, 99/1, 98/1/1…

Domestic Asset Protection Trusts

- Until 1998 it was unclear whether the United States' public policy allowed for an Asset Protection Trust. In 1998, Alaska passed their Asset Protection Trust law making it clear, for the first time in U.S. history, that the U.S. would allow for the use of an Asset Protection Trust.
- Since 1998, about 15 other states have passed similar legislation allowing for some form of an Asset Protection Trust.

What is a Domestic Asset Protection Trust?

- Must be Irrevocable
- Must contain a spendthrift clause
- Grantor may or may not be a Beneficiary or Trustee
- Might include a Trust Protector
- Does not require a foreign trustee
- No IRS reporting requirements for Domestic Trusts

Types of Domestic Trusts

- Medicaid Trust
- Spousal Access Trust
- Children's Trust
- Irrevocable Life Insurance Trust (ILIT)
- Testamentary Trust

Risks and Drawbacks of Domestic Trusts

- Article 4, Section 1 of the United States Constitution, “full faith and credit shall be given in each state to the public acts and records and judicial proceedings of every other state.”
- Alaska is a state which is supposed to protect your assets. But Alaska must also give full faith and credit to any legal judgments made in any of the roughly 34 other states that do not recognize Domestic Asset Protection Trusts.
- Existing case law is also not very favorable, as courts have been known to disregard the protections offered by these trusts.
- Annual Fees
- IRS Reporting requirements

International Asset Protection Trusts

- The Cook Islands Asset Protection Trust Law of 1984
- The Cook Islands
    - U.S. Verdicts not recognized
    - Higher standard of proof
    - Psychological barriers
    - Costs & Fees
    - Banking: Not Cooks, but Switzerland or Lichtenstein
    - No contingency fees
    - Short Statute of Limitations: 2 years for Fraudulent Conveyances
    - Loser Pays

International Asset Protection Trusts

- Trust Protector
  - Responsible for supervising and directing the acting trustee
  - Has the authority to fire/replace the trustee
  - Can replace a U.S. based trustee with an international one
  - Replacing a U.S. trustee can be crucial during litigation
  - Trust Protector can also be in an offshore jurisdiction

International Asset Protection Trusts

- Nevis LLC or Cook Islands LLC
  - Excellent alternative for Offshore Asset Protection
  - Potentially lower costs than a Cook Island Trust
  - U.S. Verdicts not recognized
  - Favorable jurisdiction for defendants
  - Psychological barriers
  - Costs & Fees

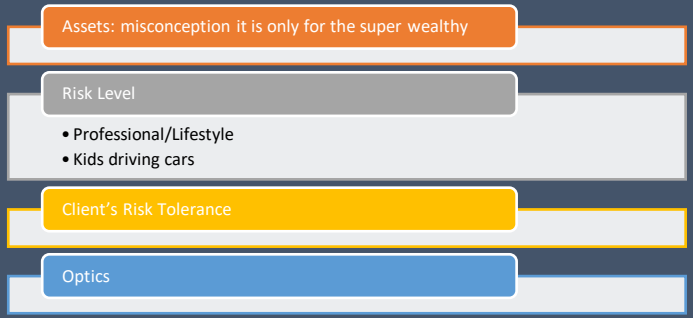
International Asset Protection Trusts

- Opening an offshore bank account
  - In order to escape U.S. jurisdictions, funds held in offshore entities should be held in banks outside the U.S.
  - Switzerland or Lichtenstein banks are excellent options
  - Generally higher account minimums $1,000,000+ or more
  - Cook Island Banks able to open accounts with only $100,000

International Asset Protection Trusts

- Why not go overseas?
  - 114/FACTA, 8938 3520, 3020-A, 1040B
  - Trustee Fees
  - International Bank Fees
  - Trustee Control
  - $5,000 to $10,000 year to maintain

Does a client need Asset Protection?



Triggering an Asset Protection Trust

There should be a conference between the Trustees, the Protector, the Estate Planning counsel, litigation counsel, and possibly others.

The foreign trustee has the power to implement protective measures by which the assets held in a jurisdiction in which the threat arose can be removed into a safe location.

The foreign trustee typically fires the domestic trustee and liquidates the Partnership

As a result of the Partnership liquidation, 99% of the Partnership's assets are up-streamed to the Trust and repositioned by the Foreign Trustee

Once the threat dissipates, the foreign trustee can consider reappointing one or more domestic trustees and reestablish the partnership

Specific Protective Measures

Removal of domestic Trustee by Foreign Trustee
Resignation of Trust Protector
Appointment of Successor Protector
Liquidation of Underlying Entities
Diversifying assets out of the jurisdiction in which there is a threat
Transfer of stock held in an S-Corp.
The Domestic Asset Protection Attorney becomes the U.S. counsel to the foreign trustee
Action considered for U.S. real property and/or entities that own property
Payment of funds to or for the benefit of the Beneficiaries, and how initiated and at whose instance
Post emergency measures reformation of overall structure
Banking: Switzerland/Lichtenstein, privacy, (not secrecy) – no U.S. presence

Fraudulent Conveyance

- Civil Remedy
  - We don’t want our planning undone or to appear as though we are assisting a fraudulent act
  - We don’t want our planning ordered to be undone
- Criminal in a few states

Fraudulent Conveyance

- Considerations when facing a potential Fraudulent Conveyance
  - Will insurance cover?
  - Avoid contempt with impossible defense
  - Fund and exempt
  - If all else fails, bankruptcy and exemption planning

In Re. Huber (Bankr. WA 2013)

- Real estate development company facing the 2007 the real estate crash
- Owner had personally guaranteed many of the company's debts
- In 2008 Huber settled an Alaska DAPT, contributed real estate and accounts receivable
- Filed for Chapter 11 Bankruptcy in 2011, tried to exclude the Trust assets from the bankruptcy estate
- Section 548(e) of the bankruptcy code: a transfer made within 10 years may be voided if it was made to a self-settled spendthrift trust with the intent to delay, hinder or defraud a creditor
- Alaska Trust company caved in and settled with the Bankruptcy Trustee; the assets were included in the Bankruptcy estate.

Dahl v. Dahl (Utah, 2015)

- The Dahls were in a contentious divorce for many years
- Dr. Dahl had established the Dahl Family Irrevocable Trust, a Nevada DAPT in 2002 but lived in Utah
- Marital Assets contributed to the Trust
- Supreme Court of Utah declined to apply Nevada law as the trust instructed, applied Utah law instead
- Court did not reach the question of whether the DAPT was enforceable because it held that the trust was actually a revocable trust under Utah law

Federal Trade Commission v. Affordable Media

- Poorly drafted Cook Islands Trust: Grantors given too much power as Trust Protector
- Unsympathetic Defendant
- Strongest creditor: IRS, they spent $10 to make $1
- IRS won in U.S., $0 collected from Cooks Islands
- Never over $1M in this Trust

Cryptocurrency as an Asset



What is the Blockchain?

- A blockchain is a decentralized ledger of transactions across a peer-to-peer network.

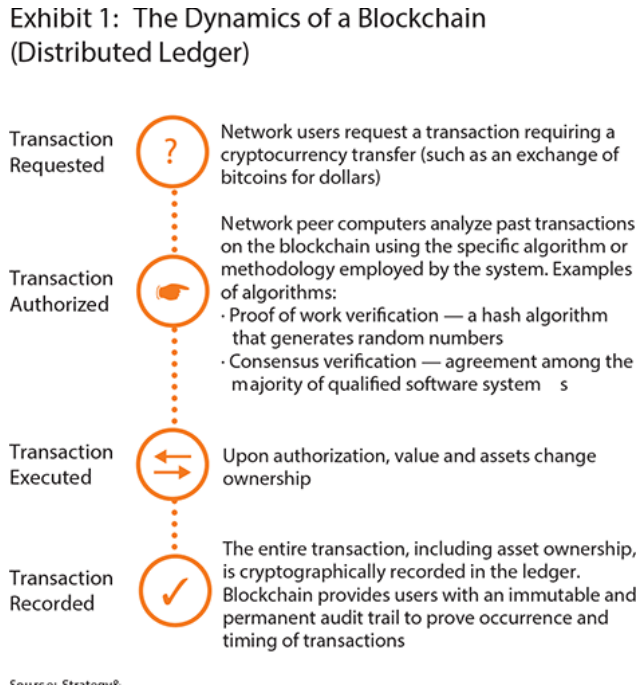
What is the Blockchain?

- Distributed electronic ledger that uses software algorithms to record transactions with reliability and anonymity
  - Ledger keeps track of all transactions

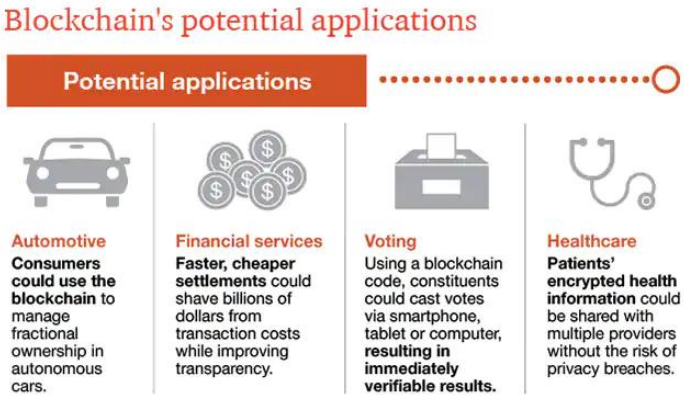
What is the Blockchain?

- Offers more effective way to process transactions
  - Payments
  - Contracts
  - Settlements

How does the Blockchain work?



Why do we need the Blockchain?



Why do we need the Blockchain?



Creates a safer method of transactions

Data blocks build on top of previous verified transactions

New transactions continue to secure previous transactions



Faster processing times

Nearly instantaneous

Global

Why do we need the Blockchain?

- Anonymous identification
  - Uses pseudonyms
  - Only reveal identification if user chooses to do so
  - Protection against identity theft

What is Cryptocurrency?



A digital token designed as a medium of exchange

Digital tokens can be used for other purposes

- Rights to use assets or services
- Representation of ownership interests



Internet-based medium of exchange

What is Cryptocurrency?

No third-party involvement

- Transfers go directly from peer-to-peer
- No bank or middleman involvement

Unaffected by inflation and deflation

What is Cryptocurrency?

Keeps a log of all transactions

- Accounts and balances
- Assets
- Contracts

Minimal processing fees

Irreversible

- Once transaction is sent, it *cannot* be reversed
- Prevents fraud



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What is Cryptocurrency?

- Decentralized from central authority
  - Theoretically immune from government entanglement
  - No central bank involvement



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What is Cryptocurrency?

- Where does it come from?
  - Mining Process
    - Miners solve complex puzzles to add to Blockchain
    - ”Miners” rewarded with Bitcoin
    - Cap on amount of Bitcoin in circulation
    - Only way to create Cryptocurrency
    - Peer-to-Peer


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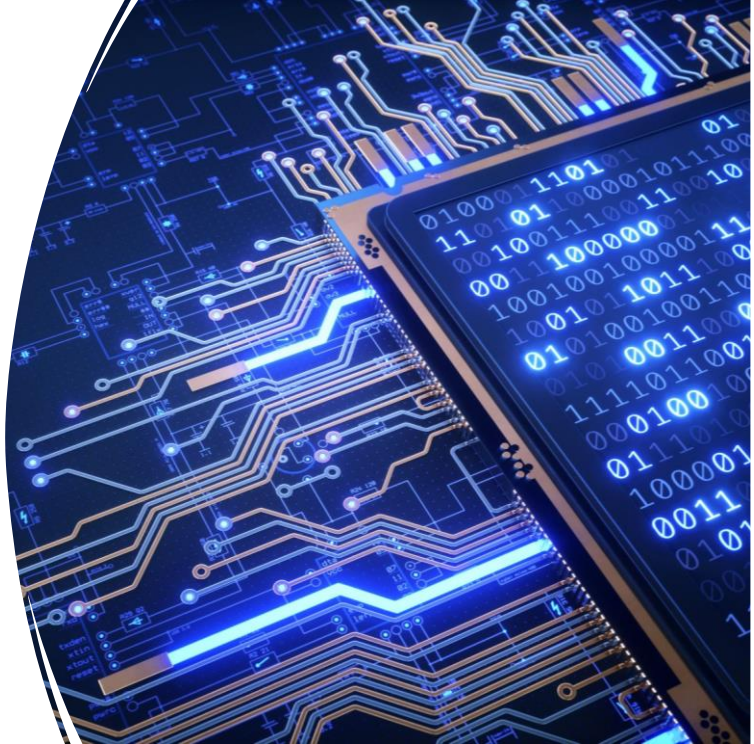
What is Cryptocurrency?

- The unknowns
  - How will it be regulated?
  - When will it be the norm?
  - Will it replace fiat currency?



How does Cryptocurrency fit into the Blockchain?

- Cryptocurrency is the reward Miners receive for mining the Blockchain algorithms
- Cryptocurrency is only one use of the Blockchain



Cryptocurrency as an Asset

- Internet-based medium
  - Can be stored internationally
  - Transfer to trust by giving trustee digital key
- Rising value in irrevocable trust
  - May be free of additional estate or gift tax
- Transactions are nearly free of tax charges
- Lower international transaction fee
- Can be converted to cash

Cryptocurrency as an Asset

- Cons of international cryptocurrency
  - Not legal in all countries
  - Not backed by federal reserve
  - Not currently regulated
  - If key is lost, cryptocurrencies are not recoverable

Cryptocurrency in Estate Planning



Universal

Combined with offshore accounts

International Assets



Unbeatable Protection of Assets

Blockchain is theoretically impossible to break or hack



Confidential

Cryptocurrency in Estate Planning



Possible Transaction Types

Contracts

Property

Records



Convenience

Internet-based

From phone

Cryptocurrency in Estate Planning



IRS currently treats cryptocurrency as property for tax purposes

Not treated as currency

Does not pay dividends

Does not accrue interest

Value fluctuates in the same way as real estate



May require appraisal for estate tax purposes

Cryptocurrency in Estate Planning

- Ease of transfers
  - Assets
  - Property
  - Software is free to download and use

Cryptocurrency in Estate Planning

- A valuable intangible asset
  - Bitcoin
  - Ethereum
  - Doge
- Investment Opportunity
  - Bitcoin stocks rising steadily
    - Peaked in late 2017 at $20,000
    - Currently sitting around $40,000
    - Continuing to rise steadily
  - Other cryptos continue to rise and fall

Cryptocurrency in Estate Planning

Fiduciary only needs decedent's password to take control of account	Estate planning documents should grant the fiduciary power to access decedent's digital assets
• No need to show death certificate • Immediate access to transfer and distribute	• Grant power to access, retain, and manage cryptocurrency • Avoid liability under privacy laws

Cryptocurrency in Estate Planning

To ensure beneficiaries can inherit cryptocurrency:

- list your cryptocurrency in your trust;
- include information about your digital wallets in your trust;
- create a memorandum to your will with passwords and PINs; and,
- include a step-by-step guide to explain how your beneficiaries can access your cryptocurrency.

Cryptocurrency in Estate Planning

- Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA)
  - Governs access to a person's account when they die
  - Allows access to manage digital property
  - Does not inherently allow access to electronic communications
  - Can consent in estate planning documents

Cryptocurrency and Offshore Trusts

- Cons of international cryptocurrency
  - Not legal in all countries
  - Not backed by federal reserve
  - Not currently regulated
  - If key is lost, cryptocurrencies are not recoverable

Cryptocurrency and Offshore Trusts

- Can be stored internationally
- To transfer to trust, just give trustee password to account
  - Contemporaneous memoranda
  - Password and assets must be updated regularly

Cryptocurrency and Offshore Trusts

- Transactions are nearly free of tax charges
- Lower international transaction fee
- Can be converted to cash
- Disclosure can be required on a financial affidavit
- Can be protected with a Cook Islands Trust



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