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Planning for Non-Fungible Tokens and Metaverse Assets

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Modern estate planning involves much more than planning for the distribution of a client's home, corporate securities, money, and family heirlooms. New types of property without tangible form are evolving rapidly from ubiquitous electronic communications such as e-mail and text messages to the generally understood realm of cryptocurrency, to the growing use of ethereal non-fungible tokens, and to the fringes of purchasing "land" in the Metaverse. Prior Studies have focused on electronic communications and cryptocurrency. This study provides an understanding of NFTs and the Metaverse using a "frequently asked question" format so estate planners will have the background necessary to provide sage advice to their estate planning clients.

Non-Fungible Tokens

What is a non-fungible token?

A non-fungible token (NFT) is an electronic asset that is uniquely identified. It is non-fungible meaning that each NFT is distinguishable from all other NFTs; no two are the same like snowflakes. It is a digital token rather than a physical token like a casino chip or a coupon. By comparison, cryptocurrency like Bitcoins are fungible tokens in that every Bitcoin is the same as every other Bitcoin.

What do NFTs represent?

NFTs may represent photographs, videos, music, artwork, on-line gaming content, tweets, and other types of digital files. Unless specifically included, the NFT does not encompass the underlying intellectual property such as the copyright for the work the NFT represents.

How is an NFT represented?

Consider an NFT as a "receipt" to provide true ownership. The NFT has a unique internet address and whomever has the address and access to it owns the NT. If the server goes off-line or is destroyed, all that remains is a broken Internet link.

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Where are NFTs stored?

NFTs are stored on a blockchain that certifies that the digital asset is unique and not interchangeable with another asset. Using a blockchain results in a record that is virtually impossible to hack.

How does a person create an NFT?

The creation process of an NFT is called "minting." NFTs are minted on a blockchain in a similar manner to cryptocurrency. Currently, Ethereum is the most popular platform but other platforms may also be used. The creator such as an artist, performer, or author links the NFT to the specific item of digital property that it represents. To enhance the value of an NFT, the creator may promise to limit the number of NFTs created. For example, the creator may decide to make only one NFT that represents the digital property or limit creation to a specified limited number (e.g., a series of ten so purchasers would own 1 of 10, 2 of 10, etc.). The minting process is described in more detail in a later FAQ.

Why does a person create an NFT?

A person creates an NFT in the hopes of selling the NFT to make a profit. Each NFT is unique; no two NFTs are the same. They may not be copied. The name of an owner of an NFT is part of the public blockchain record and thus anyone can verify ownership. NFT creators may sell their work on a global market as well as retain the right to receive royalties each time the NFT is sold by using smart contract technology.

I still am confused. Are there old-school analogies that may help me understand NFTs?

Yes. NFTs are digital counterparts of physical autographs, baseball cards, stamps, coins, comic books, artworks, and other similar collectible items.

What is the value of an NFT?

The value of an NFT depends on market forces (supply and demand) because the NFT has no intrinsic value just like other collectible items. For example, one baseball card may have significant value because it is scarce and highly sought after by collectors while another card has little or no value because a huge number of the cards are available or the person depicted is not famous.

What are some examples of notable NFTs?

The NFT of Beeple's (Mike Winkelmann) Everydays: The First 5000 Days, a collage of 5,000 individual pieces created over a 13-year period, sold for $69,346,250 by Christie's on March 11, 2021. This is said to be the most expensive NFT ever sold and the first by a major auction house.

In the on-line game CryptoKitties, a digital cat sold for $172,000. The game is designed for players to buy, trade, and breed digital cats.

An NFT of a short video entitled Lebron James: Dunk From the Top sold for $208,000.

Major League Baseball sold a digital copy of Lou Gehrig's Luckiest Man speech for $70,400 on July 4, 2021.

The swag bag at the 2021 Oscars included an NFT of Chadwick Boseman, the actor who portrayed the Marvel superhero Black Panther.

An NFT of the first tweet by Jack Dorsey, the co-founder of Twitter, sold for $2.9 million.

Other than collectibles, what are some other possible uses of NFTs?

NFTs could be used to secure and authenticate physical assets, both personal and real property. There is also speculation that NFTs could operate as a highly secure method of transferring title to real property and to store electronic wills and other estate planning documents.

How do NFT owners store and access their NFTs?

NFTs reside in digital "wallets" that can be stored in many different ways such as on an exchange accessed over the Internet, software on a computer, tablet, or cell phone, or on a dedicated flash drive. To be able to retrieve an NFT and transfer it, the person must have the private key or the seed phrase, that is, a list of random words (typically 12, 18 or 24 words) which allows the person to recover the wallet containing the NFT. A seed phrase would look something like this "warlock implode lawyer drink love close cactus river street double water most." These words are tied to the private key through a complex computation process. The seed phrase needs to be kept secure at all times. Otherwise, anyone with knowledge of the phrase could access the NFT. If the wallet resides on a commercial platform, the NFT may be accessible by a person who knows the user name, password, answers to security questions, and has the ability to satisfy other verification steps.

What is the first step I need to take regarding NFTs when working with an estate planning client?

It is essential for you to determine if your client owns or intends to purchase NFTs. You should include a question on your client intake questionnaire or in your initial client interview. If you do not know your client owns NFTs, you will not be able to help your client plan for them properly.

What type of records should a client keep about NFTs?

The client must keep careful records of the price paid for each NFT and the price for which it is sold so that the correct amount of capital gain or loss is reported for tax purposes.

Is there a special concern if the client purchases an NFT with cryptocurrency?

Yes. Most clients will purchase NFTs with cryptocurrency rather than traditional money which will lead to an additional concern. Cryptocurrency is property, not money. Thus, if a client uses cryptocurrency to purchase an NFT, a capital gain or loss will occur based on the price the client paid for the cryptocurrency that the client used to purchase the NFT. This gain or loss must be reported for tax purposes.

Should the client consider holding NFTs in a business entity?

Yes. The client may wish to hold the NFT in an entity such as a limited liability company (LLC). Potential advantages include (1) the ease of transfer of LLC interests compared to transferring the NFT itself which requires a blockchain transaction, (2) transfer tax discounts may be possible as the LLC interests may be minority in nature or there may be a lack of marketability, and (3) asset protection.

How should the client protect the information needed to access NFTs?

The private key or seed phrase required to access the digital wallet in which the NFT is stored must be protected while the client is alive and then transferred to the beneficiary upon the client's death. Just like cryptocurrency, without the means of accessing the NFT, it will be lost forever. Some clients elect to keep this information in their safe deposit boxes in old-school written form or on a flash drive or other digital media which may also be encrypted to add another layer of protection. Others will engrave the information on a metal plate to assure it will survive fires, floods, hurricanes, tornadoes, earthquakes, and other disasters. Some people will use complex methods such as dividing the seed phrase into sections and storing them in different places so that only by bringing them all together like the Infinity Stones can the NFT be accessed. An even more sophisticated method is Shamir Secret Sharing where an algorithm is used to divide the seed phrase into multiple seeds (e.g., five) and the client indicates how many (e.g., 3) need to come together to create the entire seed phrase.

A client may also elect to store NFTs on an on-line exchange such as Coinbase, Kraken, or Gemini. Using an exchange makes it easier for a client to deal with NFTs and transfer them. However, these "hot wallets" are less secure and more subject to hacking than "cold wallets" (e.g., flash drives) which are not connected to the Internet.

How should a client's will address NFTs?

The client may make a specific gift of individual NFTs or a general gift of all NFTs the client owns. If NFTs are not specifically mentioned, they will pass under the will's residuary clause. As discussed previously, it is important to provide a method of transferring the NFT access information to the beneficiary outside of the will. Access information should not be included in the will because it becomes a public document once filed for probate.

If the client's NFT collection is extensive, the client may wish to consider appointing a separate "digital executor" who has the responsibility of dealing with digital assets for the benefit of the client's estate. Even if a separate person is not appointed, the client may wish to direct the executor to hire a person with the skills needed to prudently manage NFTs.

I am a personal representative of a decedent's estate. Can I access the decedent's NFTs?

Yes, a personal representative has the authority to access NFTs under the Revised Uniform Fiduciary Access to Digital Assets Act which has been enacted in almost all states. However, the authority to access NFTs is worthless unless the personal representative has the access information.

I am a personal representative of a decedent's estate. Is there anything special regarding NFTs about which I should be immediately concerned?

Yes, you should document the value of the NFT as of the date of the decedent's death. The beneficiaries who receive NFTs are entitled to a step-up in basis to the value of NFT as of the date of the decedent's death rather than the decedent's basis. If the NFT has increased in value since the time of purchase, being able to document the date of death value will reduce the amount of capital gains taxes owed when the beneficiary sells the NFT. There is, however, a significant problem in that there is no good method of valuing NFTs. For example, Sina Estavi purchased the NFT of Jack Dorsey's first tweet for $2.9 million. Later, when he attempted to sell the NFT, the highest bid he received was $6,800.

I am a trustee. Can I retain NFTs in a trust or invest in NFTs?

In almost all states, a trustee is bound by the prudent investor standard, that is, investment decisions must be made "in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust." The value of NFTs is extremely volatile and would likely be considered too risky of an investment for a prudent investor. Accordingly, a trustee should be very hesitant to retain or invest in NFTs without express permission from the settlor in the trust instrument, a written release by all beneficiaries, or authorization in a valid court order.

Are there any religious-based considerations I need to keep in mind with respect to NFTs?

Yes. Some religions may frown upon its members investing in cryptocurrency and perhaps NFTs as well. For example, at least one Islamic council ruled that using Bitcoin and other cryptocurrencies as a means of payment is unlawful under Islamic law because they are deemed gambling due to the price volatility.

If I plan on advising clients about NFTs, is there anything else you would recommend that I do?

Yes, I recommend that you create a digital wallet and create an NFT. You will learn a great deal by going through the process yourself and then you will not be like a marriage counselor who has never been married giving advice on how to maintain a successful marriage. Here are the basic steps you can take:

Locate a website or application that streamlines the NFT minting process considering the ease of use and the cost (referred to as gas) you will pay to compensate for the computing energy needed to process and validate the NFT transaction. Create an account with a user name and password. Note that most apps link to the most popular NFT blockchain, Ethereum. Many of these platforms will walk you through the process described below in a step-by-step manner.

If you do not already have a digital wallet in which you can store NFTs, create one and obtain the seed phrase. Link the app to the digital wallet using an extension to your Internet browser or smartphone app.

Take and save a picture on your computer or phone of something you think is interesting, e.g., your office, favorite pet, a selfie, the view out your window, etc.

Follow the steps in the app to upload the picture and mint an NFT linked to the picture.

You can either keep the NFT in your wallet, transfer it to someone else's wallet, or list it for sale at a fixed price or as an auction item.

If my client mints NFTs, are there any additional special warnings I should provide the client?

Yes, the client needs to be leery of creating NFTs that link to copyrighted work without permission of the copyright holder. "[U]nder U.S. copyright law, the creator retains exclusive rights to reproduce and distribute copies of, make derivatives of, and publicly perform and display the copyrighted work." Thus, a client should not mint an NFT that is linked to copyrighted property such as songs, videos, and artwork.

Why should a charitable organization consider accepting NFT and crypto-currency donations?

NFT investors are disproportionately charitable, and the recent significant appreciation of NFTs may lead many investors to consider donations as a potential method of tax alleviation. One platform for crypto donations, The Giving Block, reported a total of $69 million in donations in 2021, a number that is projected to grow in the coming years.

Also, organizations that operate internationally like UNICEF and the Red Cross have found accepting crypto assets to be particularly useful. Accepting crypto donations allows organizations like these to easily transfer money around the world quickly without paying wire fees.

Due to their volatile nature, is it risky for charitable organizations to accept crypto assets?

The valuation of crypto assets is notoriously difficult, maybe impossible, therefore it is understandable that an organization may be wary about accepting crypto donations. It may be advisable to have a policy in place that determines whether the organization will liquidate the asset immediately, which is typically recommended, or hold on to the crypto for investment. If you do choose to keep donated crypto assets, guidelines for when the organization will liquidate may also be helpful. Most platforms that assist with crypto donations will liquidate immediately, thus minimizing any risk of value fluctuations.

How can a charitable organization accept crypto donations?

The first option is outsourcing the donations to a third-party platform. This may be an attractive option for organizations who wish for a "hassle-free" method for accepting crypto donations. Companies such as Bitpay, Engiven, or The Giving Block can integrate crypto donations directly to a website and convert the donated crypto into USD, with fees ranging from 1% to 5%. However, organizations with adequate capacity and expertise may seek to manage crypto donations in-house. Under this approach, an organization would need to establish an account with a crypto exchange where they would be able to accept donations directly from donors. The appeal of this approach is a lower trading cost and a wider array of tokens that are able to be accepted; however, this approach would require the organization to be more involved in the crypto donation process and more technologically savvy. Donors may also use a donor advised fund to donate crypto. In this scenario, a DAF sponsor that accepts crypto donations will generally liquidate the asset prior to it reaching your organization, making it no different than other donations.

Are there any specific reporting requirements for crypto donations?

The IRS has made clear that charitable organizations should treat donations of crypto assets as noncash contributions. Generally, an organization can accept donations of crypto in the same manner as they accept appreciated stock or other types of property. Organizations must also file Form 8282 if they sell, exchange, or otherwise dispose of its cryptocurrency within three years after the date they originally received the property.

How are crypto assets treated for accounting purposes?

The US Financial Accounting Standards Board has yet to directly address how crypto assets are to be treated for accounting purposes, despite numerous calls to do so. For some nonauthoritative guidance, the Association of International CPAs has released "Accounting for and auditing of digital assets," which may include some helpful guidance.

Do crypto assets pose any ESG concerns for my organization?

A large amount of energy is required for their production. Bitcoin alone has an annual energy consumption that is larger than countries like Argentina and is in excess of Google, Apple, Facebook, and Microsoft combined. Further, the majority of this energy does not come from renewable sources. There are efforts in place to make crypto and NFTs more efficient and consume far less energy; however, your organization should consider whether crypto donations align with your organizational mission. Another concern with crypto assets is their association with illicit activities. Given their generally pseudonymous nature, crypto is a favored medium of exchange amongst criminals and other bad actors. However, as crypto assets are gaining more widespread usage, this association is declining.

Why should my client consider donating crypto assets?

Aside from the general reasons why a client might otherwise donate to charities, donating crypto can help to avoid the tax burden that the client would otherwise experience from transferring appreciated crypto into USD. Crypto investors are required to recognize any capital gain or loss that they realize upon a disposition of crypto, whether that is into USD or another cryptocurrency. A donor will not recognize gain or loss from a donation of crypto, and they also may be entitled to a charitable contribution deduction. Because of this reality, donating crypto allows more funds to reach charitable organizations than if crypto assets are first converted into USD. This also makes donations particularly enticing for crypto investors with highly appreciated assets.

How can your client receive a charitable contribution deduction from a crypto donation?

If the client is itemizing taxes, the client may be able to receive a fair market value charitable deduction for the tax year in which the client made the gift. Donors seeking a deduction for their donation will need to obtain a donation receipt, which is done automatically by many platforms. If the crypto asset was held for investment for more than one year, the client may deduct the value of the gift up to 30% of the AGI for the year. If held for one year or less, the client may deduct the lesser of cost basis or fair market value at the time of the contribution up to 50% of the AGI. If the client is seeking to claim more than $500 on non-cash donations, the client will need to file Form 8283. To substantiate a deduction of over $5,000, the donor will need to obtain a qualified appraisal. This requirement is currently difficult to meet for the burgeoning crypto market, as qualified appraisers need to have two years of experience in valuing the type of property being appraised. While crypto investors hope for a relaxing of this rule in the future, crypto appraisals currently are expensive and difficult to find.

What type of crypto assets can be donated?

Any crypto asset can be donated; however, platforms, organizations, and DAF sponsors that accept crypto will generally specify the types of cryptocurrencies and NFTs that they will accept for donations. Given the recent craze surrounding NFTs, some investors may be curious whether they are able to donate their NFTs to charitable organizations.

Again, while possible, most organizations will not have infrastructure in place to accept and make use of NFTs. Instead, it is recommended that donors auction NFTs themselves and direct the payout to the charitable organization of your choice. This has become a popular option for NFT holders, and it allows for organizations to receive charitable donations in a more liquid form.

What are some future issues I may be asked to address about NFTs?

There are several potential issues regarding NFTs beyond those already mentioned that may cause concern in the future. Once example is whether NFTs could be subject to federal security laws. Another example is whether NFTs are commodities so that they would be subject to regulation by the Commodity Futures Trading Commission.

Metaverse Assets

What is the Metaverse?

The metaverse is a network of three-dimensional virtual worlds focused on social connection. Although this sounds like a very new concept, the term was coined thirty years ago by Neal Stephenson in his novel Snow Crash. The book involved, among other things virtual real estate and the creation of 3-D avatars.

What are some early uses of the Metaverse?

For several decades, multi-player on-line video games have created virtual realities where players interact with their environments, other players, and game-specific characters. For years, players have accumulated virtual property in these games which may have significant monetary value. For example, a planet for the Entropia Universe sold for $6 million in 2011 and an asteroid space resort for the same game sold for $635,000 in 2010. There are also reports of more "reasonable" prices for virtual items such as a virtual sword for use in Age of Wulin which was sold for $16,000.

How is the Metaverse expanding today?

Technological advances now permit users to access the metaverse via high-quality virtual reality headsets rather than a traditional gaming headset, computer, or television screen. The virtual realities are expanding from being game- or company-specific to being interactive and networked. The lofty goal is to have one place from where all virtual worlds may be accessed. In other words, instead of having compartmentalized virtual areas (e.g., walled castles), a user may travel between them all (e.g., roads). However, the standardization necessary to travel between different virtual worlds with a user's virtual assets intact is technically extremely challenging and will involved complex intellectual property issues. Thus, it is likely to be a long time before traveling between different companies' virtual worlds will be possible.

Other than gaming assets, what is a common type of Metaverse property?

Dozens of companies are now selling virtual versions of existing real property. For example, I purchased our home address on Tiliaverse for about $100. As with physical land, location is key. For example, the U.S. Capital's purchase price as of November 1, 2022 was $1,534.

How do I address Metaverse assets in a client's estate?

The first thing a prudent estate planner must do is to inquire whether their clients own metaverse assets. Only by recognizing that a client has these assets can the estate planner take the steps needed to be sure these assets are not lost upon the client's death or disability.

Metaverse assets are typically represented by NFTs and thus the same planning steps for NFTs apply such as the preservation and transfer of passwords and seed phrases. Failure to make these plans may result in a personal representative, heir, or beneficiary not having access to the asset and thus the value would be lost.

Assuming the personal representative has the access information, the representative may use the Revised Uniform Fiduciary Access to Digital Assets Act to access the virtual property and take appropriate steps to handle it in the estate. The value of the metaverse assets needs to be documented as of date of death so these assets are entitled to the step-up in basis. Unfortunately, obtaining a true market value of these assets is very difficult for lack of a standardized market.

How do I address Metaverse assets held in trust?

The owner of metaverse assets may transfer them to a trust. How should a trustee deal with these assets given the prudent investor standard which request investment decisions to be made "in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust"? The value of metaverse assets is extremely volatile. Trustees should be very hesitant to retain metaverse assets without the settlor's express permission in the trust instrument, a release signed by all trust beneficiaries, or a court approved authorization.

Conclusion

Estate planners will have a growing number of clients who own NFTs and Metaverse assets. To provide the best service possible to clients, estate planners must have a basic understanding of these assets which this Study provides. Rapid changes and developments are likely so it is also important for estate planners to watch for them and then adapt as needed.

Footnotes

1 See Jacob Kastrenakes, *Beeple Sold an NFT for $69 Million,* The Verge (Mar. 11, 2021).

2 See Mark Serrels, *Someone Just Bought a Cryptocurrency Cat for $172,000*, CNet (Sept. 4, 2018).

3 See Elizabeth Lopatto, *Top Shot is Playing the Long Game in the NFT Craze*, The Verge (Mar. 30, 2021).

4 See Kenneth Rapoza, *MLB Goes All In On NFTs With Lou Gehrig, Now LA Dodgers Art. Why is This Still a Thing?*, Forbes (July 12,2021).

5 See Nancy Dillon, *Chadwick Boseman Gets NFT Tribute in Oscar Nominee Swag Bags*, NY Daily News (Apr. 25, 2021).

6 See Taylor Locke, *Jack Dorsey Sells His First Tweet Ever as an NFT for Over $2.9 Million,* CNBC (Mar. 22, 2021) (The tweet says, "just setting up my twttr," and was posted on March 21, 2006).

7 See I.R.S. Notice 2014-21.

8 See Joshua Caswell & Leigh E. Furtado, *NFTs for Estate Planners, Not Just a Token Concern,* PROB. & PROP., Sept./Oct. 2021, at 10, 13.

9 See Sidd, The Ultimate Guide to Safe Seed Phrase Storage, http://whatismoney.info (last visited Nov. 6, 2022).

10 I.R.C. § 1014.

11 The NFT for Jack Dorsey's first tweet ever is worth only $6800 now, Business Insider—India (Apr. 18, 2022).

12 See Indonesian Islamic body forbids crypto as currency, CNN.Com (Nov. 11, 2021).

13 For example, https://www.Mintable.app.

14 For example, https://MetaMask.io which you can access on your computer or via a phone app.

15 Richard Acello, Big Money, ABA J., Oct./Nov. 2021, at 25, 26.

16 See Richard Acello, *Big Money*, ABA J., Oct./Nov. 2021, at 25, 26.

17 Andrea Divirgilio, *Most Expensive Virtual Real Estate Sales*, Bornrich.com (Apr. 23, 2011) (also discussing other high priced sales of virtual property); Oliver Chiang, Meet *The Man Who Just Made a Half Million From the Sale of Virtual Property*, Forbes.com (Nov. 13,2010).

18 Katy Steinmetz, *Your Digital Legacy: States Grapple with Protecting Our Data After We Die*, Time Tech (Nov. 29, 2012).