



# Structuring for Crypto Assets

Navigating the maze



Crypto currency has increased in popularity over the years, becoming more and more mainstream. However, whilst previously it was largely shunned by the financial community, its increased use has become impossible for banks to continue to ignore. Banks are now taking tentative steps to holding and offering crypto currency as part of someone's portfolio, albeit with restrictions and limitations.

With its popularity on the rise, many ask the question as to why this is the case, how they can hold crypto, and what they should do to protect themselves from any risks associated with this.

### Worldwide Crypto Wealth Statistics

	ALL CRYPTO		BITCOIN	
	Total	Growth % (1 year)	Total	Growth % (1 year)
Millionaires	172,300	+95%	85,400	+111%
Centi-Millionaires	325	+79%	156	+100%
Billionaires	28	+27%	11	83%
Total Crypto Users (million)	560	+32%	275	+31%
Total Market Value (USD trillion)	2.3	+89%	1.2	+103%

Notes:

- Total crypto includes Bitcoin and all other known cryptocurrencies.
- Millionaire figures rounded to nearest 100.
- All statistics as at 30 June 2024.
- \*One-year growth rate from 1 July 2023 to 30 June 2024.

Crypto wealth tiers:

- Millionaires — Individuals with crypto holdings of USD 1 million or more
- Centi-millionaires — Individuals with crypto holdings of USD 100 million or more
- Billionaires — Individuals with crypto holdings of USD 1 billion or more

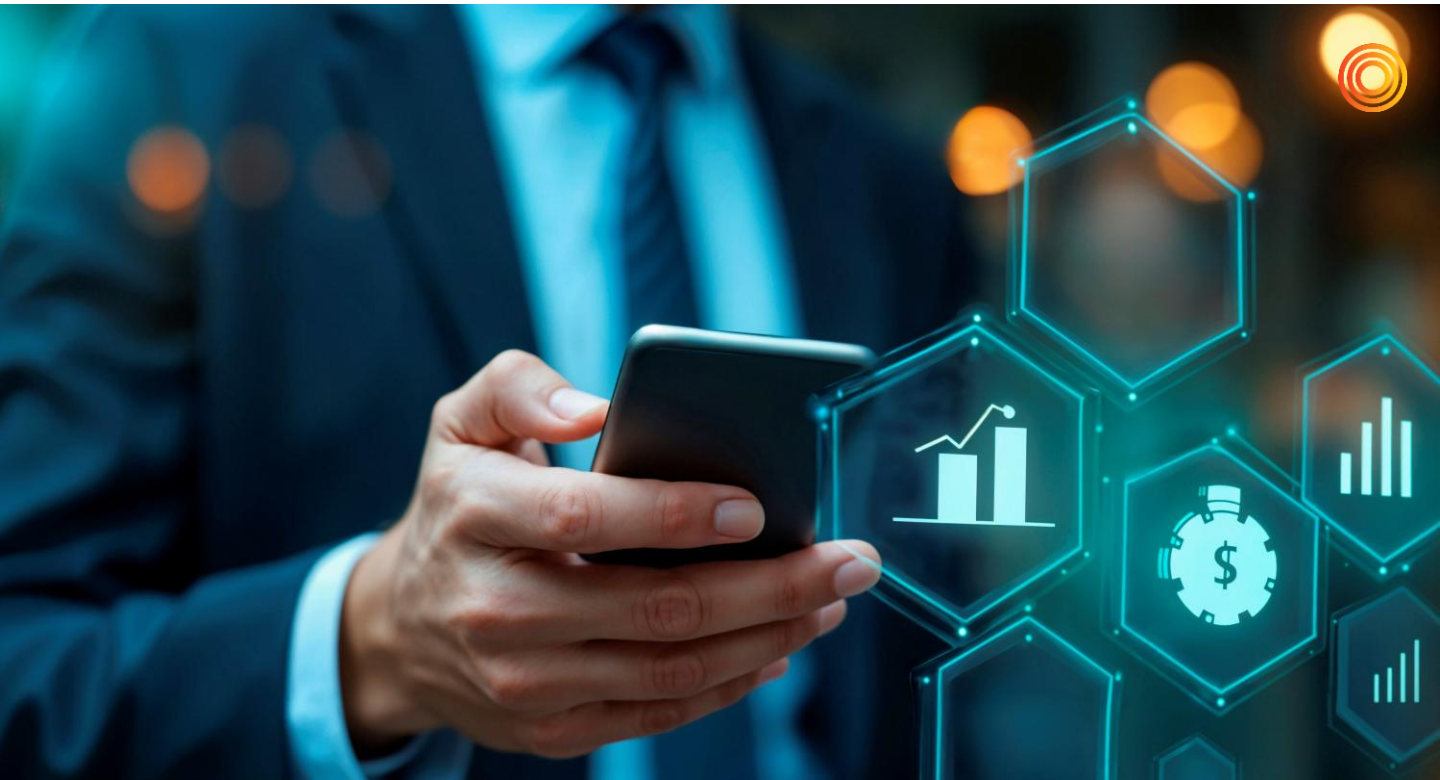


# History of non-mainstream finance

Cryptocurrency or digital currency such as Bitcoin, originated in the 1980s but gained popularity in the 2000s as people looked for different ways to be less reliant on banking systems, as the 2008 financial crisis highlighted their weakness. Cryptocurrencies rely on a decentralised format for storage and transfer, bypassing banks in their flow.

It is this decentralisation that differentiates cryptocurrencies from other fintech platforms, typically seen in easing transfer of funds in emerging markets, such as Africa. Mukuru and M-Pesa were developed to help facilitate the transfer of funds across countries where users had limited access to banking systems. Here, an SMS was used to communicate the transfer of funds from one person to another. However, the funds still needed to be transferred from one bank to another.





DeFi (decentralised finance) now appears to be breaking all the traditional norms that professional advisers have historically relied upon such as use of custodians within particular borders, verification by intermediaries and definitive contracts. Now, a borderless smart contract (code) can be used between willing counterparts without the need for any intermediaries, existing only on the internet – the key (*no pun intended*) is the holding of a private key.

Aside from valuation issues and concerns held by professional advisers who point to the lack of fundamentals to support the ability to accurately value crypto currencies and perceived weaknesses in anti-money laundering regulation, such advisers need to become more aware of the main risks for investors and holders of cryptocurrencies, irrespective of whether they advise on them or not.



# Practical Issues

Investors are looking at this trend and, not wishing to miss out on a potential opportunity, are investing into this asset class with or without the knowledge of their advisors. For those advisors, it is important to flag up the following practical points that clients need to bear in mind both before they acquire cryptocurrency, and whilst they hold it:

- Documenting what they hold is vital, as is keeping up to date ledgers;
- Ensuring safe custody of the private key is equally important – if no one knows about the private key, and something happens, to the individual, that private key is all but lost, along with the value of the wallet – even if a will bequeaths crypto currency, if the private key cannot be located and safely passed on, the will itself is worthless

Approximately 2.3 to 4 million Bitcoin are estimated to be permanently lost due to forgotten keys or damaged storage. These, often called "zombie coins," are rendered inaccessible due to forgotten private keys, damaged hardware, or death of the main holder. The most famous case is James Howells, who mistakenly had a hard drive thrown away in 2013 containing 8,000 BTC, and has spent over a decade trying to get permission to search a landfill.

<https://www.bbc.com/news/articles/c620jej4kd4o>

Proper planning for safeguarding your digital assets is therefore an extremely important, yet an often ignored area.



Besides, practical challenges for any professional advisor when dealing with Defi include what would happen from a legal perspective if there was a dispute between parties e.g. a divorce, or estate dispute. Because of the virtual nature of the holding of this asset, there are still unknown elements about succession and recovery of the assets – executors and lawyers could spend years trying to recover the assets without success. In the case of a dispute, questions of which country could have legal rights over the transaction are raised, as well as enforcement rights.

Finally, when considering tax matters, much depends on the reasons behind the individual holding the crypto currency. If this is frequently traded for a profit, this could be considered a trade and profits would therefore be subject to income tax. If more as a 'hobby', this could be considered as a capital gain. Different countries have different tax rules relating to taxation of income and capital gains e.g. UAE, Switzerland, Singapore etc. which could lend itself to an arbitrage of holders of crypto currency.





# Structuring for Crypto Currency

For corporate service providers (CSPs), and individuals looking to sit on foundation councils and otherwise occupy positions which have fiduciary obligations, holding crypto assets and navigating the DeFi space comes with opportunities but also risks that need to be understood, and managed properly.

Fiduciary obligations incumbent on council members, professional trustees and company directors include legal and regulatory commitments to uphold and monitor, such as data protection laws, confidentiality obligations and evidentiary standards, and AML regulations and suitability obligations to be properly adhered to and discharged. There is a fiduciary duty to ensure documentation is maintained for a clean source of wealth /source of funds from Fiat to Crypto. Record keeping is therefore crucial as the DeFi and traditional financial worlds overlap.

An overly simplified approach by a CSP or trustee could be to receive cash and convert it into cryptocurrency, in line with a client request. However, for corporate service providers, there is also a need to safeguard assets – with cryptocurrency defying all the traditional rules that have so far been adopted. There is a standard of care to be met though there is no court case yet for determining the level of knowledge required.



So what should CSPs – or those advising them – do? The easy option would be to refuse to hold crypto. However, one thing is clear – cryptocurrency is here to stay and will only grow in relevance. The better choice is for CSPs and others to prepare themselves, taking a number of steps to ensure they are as best positioned as possible:

- ① Educate themselves about cryptocurrencies – how they work, how they are held, regulated and managed. Knowledge is crucial and you need to make yourselves aware;
- ② Keeping documentation relevant and up to date with better provisions regarding digital assets, segregated wallets etc.
- ③ Spend time drafting/or amending existing documentation to specifically cover cryptocurrency, building in safeguards and governance frameworks for holding this particular type of asset class;
- ④ Protect yourselves – consider legal protections, insurance against hacking etc, determine how the asset will be categorised and document a operational system for holding these. This would include documenting suitability and the risk of the transaction and rationales, as well as looking carefully at matters like automated succession issues such as time lock transfers;
- ⑤ Surround yourself with qualified and experienced persons – use people who have knowledge in this field to help monitoring and decision making;
- ⑥ Determine how the asset is to be classified – be it a financial position/legal claim, intellectual property/financial product, derivative etc. This includes defining a methodology for valuations, which can be a practical headache, given the speculative nature and volatility of cryptocurrency which makes probate, tax filings, accounting, and distribution decisions more complex.



# Keeping pace with change

Technological advancement is inevitable and our advice is to be proactive with clients, keep up to date with developments, be willing to embrace change and allow the flexibility of structures to evolve with the times. Involve your CSPs and advisors, keeping your records and documentation up to date, and your dialogue with clients as frequent as possible will put you in a strong position to help navigate this new frontier.

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