

Insights

Cryptocurrency and Divorce

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Cryptocurrency has gone from being a niche, mysterious quantity to a rapidly growing form of investment for many. Given its rise in popularity, cryptocurrency has become an important asset that cannot be overlooked in a divorce action. However, due to its relatively novel nature, cryptocurrency holdings may be unknown to a divorcing spouse. A CNBC article discussed this very issue, highlighting a New York divorce where a wife “thought it was suspicious that her spouse, who earned \$3 million annually, didn’t have any assets.” After spending more than a year in discovery, with the help of a forensic accountant, the wife learned that the husband had cryptocurrency—worth half a million dollars—in a previously undisclosed crypto wallet.

Still a relatively misunderstood asset, cryptocurrency must be disclosed, valued and distributed—just as stock or other investments must be—in a divorce action. To combat potential deception or confusion, the questions that arise in a divorce include: What is cryptocurrency? How do I find it? And how do I deal with it once I’ve found it?

What is Cryptocurrency?

Cryptocurrency? Cryptography? Blockchain? What does it all mean?

Simply put, cryptocurrency is digital or virtual currency. It does not exist in physical form, like paper money, and does not use a central authority, such as a government or bank, to maintain it. Instead, individual cryptocurrency ownership records are stored in a digital ledger—i.e., a computerized database of decentralized networks based on blockchain technology. A blockchain is a continuously growing list of records, called blocks, which are linked and secured on a network using peer-to-peer review and cryptography (i.e., algorithms and code techniques that keep information secure or encrypted).

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There are thousands of different types of cryptocurrencies, the first of which and most widely known is Bitcoin. Cryptocurrency coins other than the well-known Bitcoin are termed “altcoin” and include, by way of example, Ethereum and Tether. Cryptocurrency is known for its price volatility, often having rapid surges and crashes in value, which is determined by supply and demand.

Cryptocurrency is purchased through an exchange or trading platform. Once purchased, ownership is recorded through two keys: (i) a public key, which is the encrypted information that creates the investor’s wallet address where the cryptocurrency is sent; and (ii) a private key, which allows the purchaser to decrypt the information, i. e., unlock or access their virtual currency. The investor must determine how they wish to store their private key, which must be kept confidential and safe to avoid theft. While an investor can store the cryptocurrency on the exchange/platform from which it was purchased, most utilize non-custodial “crypto wallets,” which are software for which there are various options depending upon the type of cryptocurrency held, as well as various levels of security. Because of their connectivity to the internet, these are termed “hot” wallets. In some instances, an investor may choose to hold their cryptocurrency in a “cold” wallet, which is a physical, external hardware device that is not connected to the internet. The latter is considered the least at risk of being hacked or compromised, but certainly, for divorce purposes, can also mean the least likely to be discovered by an unsuspecting spouse.

How to Find It

Cryptocurrency is not always on a spouse’s radar when identifying the marital assets at issue in their divorce and, therefore, can easily go undisclosed and undetected. Just like tax returns or bank statements, which may reveal financial information unknown to a spouse, discovery into whether and to what extent crypto investments exist should be a consideration in any divorce action.

In most divorce cases, parties are generally required to exchange certain basic or initial financial disclosures. Recognizing the ever-growing need for transparency related to a spouse’s virtual currency holdings, in 2021, Florida amended its initial “mandatory disclosure” rule to require a party to a divorce (or other family law matter) to provide:

The most recent statement and statements for the past 12 months for any virtual currency transactions in which either party to this action participated within the last 12 months or holds an interest, including those held in the party’s name individually, in the party’s name jointly with any person or entity, in the party’s name as trustee or guardian for a party or a minor or adult dependent child of both parties, or in someone else’s name on the party’s behalf. . . A listing of all current holdings of virtual currency shall also be disclosed.

In addition to mandatory disclosure, as part of the divorce, a party can seek discovery of cryptocurrency through various other means, whether additional document requests, interrogatories or through deposition. Through discovery, a party can identify a comprehensive list of all cryptocurrency assets held by the exchanges or wallets where they are located, as well as all relevant initial investments and transactions related to these holdings.

Given its decentralized and anonymous nature, cryptocurrency may be difficult to track, especially if it is stored only in a “cold” wallet. If a party is suspicious of undisclosed assets or is unsure of how to locate virtual currency, they may be wise to hire a forensic expert (including a computer forensic expert and forensic accountant). Forensic experts can assist in locating cryptocurrency, whether, for example, by tracking withdrawals or transfers made for initial purchases of cryptocurrency, or by locating login credentials or signs of a digital wallet upon inspection of a spouse’s computer or smartphone.

How to Value & Deal With It

Drastic fluctuations in price can make valuing cryptocurrency as difficult as finding it. If cryptocurrency holdings are discovered, one of the first inquiries is often what initial investments were made for the purchase of the asset, from where did the funds originate to purchase the asset (i.e., such as a marital bank account), and for how much. The next inquiry is often whether that initial investment has paid off (i.e., increased in value) or, in some cases, been lost entirely.

In this regard, determining the value for cryptocurrency may prove challenging. Should the value attributable to the cryptocurrency in the distribution of the marital assets be the initial investment made if the investment lost money? Should the value of the currency be as of a certain date—such as the date of initiation of the divorce—even though the price may vary widely day-by-day before and after that date? Should the value be an average price? Parties may also need to consider tax implications associated with cryptocurrency, which could affect a value for divorce distribution purposes as well.

Once a value is agreed upon or determined by the court, the last question is, who keeps the asset? Given the volatility of price fluctuations, some spouses may prefer to have the investing spouse keep the cryptocurrency holdings at a reasonable value, thereby entitling the other spouse to retain more of another (perhaps more predictable) asset instead. Others may elect to “go along for the ride” and divide the cryptocurrency holdings with their spouse, which one may choose to do if they believe the value may increase significantly in the future. In doing so, the spouse without much knowledge of cryptocurrency will need to ensure they educate themselves on the nuances of owning cryptocurrency and how to protect their interests moving forward.

In the end, while initially locating and valuing cryptocurrency may have its challenges, including this asset in the distribution scheme may be a necessary and considerable component of the parties’ overall marital net worth and, therefore, an important piece of the puzzle in ensuring that a spouse has received their fair share of the marital estate in their divorce.