CHRISTIAN MANAGEMENT ASSOCIATION

January 1, 2017

Tax Implications of Crowdfunding

In an information letter published in July of 2016, the IRS explained its current position on the tax treatment of crowdfunding by looking to general principles of income inclusion.

In the Letter the IRS explained that under Code Sec. 61(a), except as otherwise provided by law, gross income includes all income from whatever source it is derived. Gross income includes all funds, whether realized in the form of cash, property or other economic benefit. However they noted that some benefits that a taxpayer receives are excludable from income, either because they do not meet the definition of gross income or because the law provides a specific exclusion for certain benefits that Congress chooses not to tax.

The Service goes on to note once income has been received it can be considered for tax purposes. *Reg. §1.451-2*, sets out the "constructive receipt" doctrine and stipulates that income, although not actually "reduced to a taxpayer's possession" (e.g. physically in the recipients hands) , is constructively received by him in the tax year during which it is credited to his/her account, set apart for him or her, or otherwise made available so that he/she may draw upon it at any time, or so that he/she could have drawn upon it during the tax year if notice of intention to withdraw had been given. The regulations further provide that income isn't constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. However, a self-imposed restriction on the availability of income doesn't legally defer recognition of that income.

When it comes to crowdfunding the consideration received by contributors in return for their contributions can vary considerably noted the IRS. Sometimes contributors receive nothing but the personal satisfaction of helping to launch a cause or create an innovation that they believe in. However, often contributors are offered "rewards" of small or nominal value, such as cups with a logo, tee shirts, or tickets to an event. In other cases, contributors may receive the right to have their contributions repaid with interest if the campaign is financially successful. Or they may receive an equity interest in the endeavor (i.e., a piece of the business).

The IRS concluded that generally, money received without an offsetting liability (such as a repayment obligation), that is neither a capital contribution to an entity in exchange for a capital interest in the entity nor a gift, is includible in income. The facts and circumstances of a particular situation must be considered to determine whether the money received in that situation is income.

What that means is that crowdfunding revenues generally are includible in income if they are not:

- loans that must be repaid;
- capital contributed to an entity in exchange for an equity interest in the entity; or

- gifts made out of detached generosity and without any "quid pro quo."[1]

In addition, crowdfunding revenues must generally be included in income to the extent they are received for services rendered or are gains from the sale of property.

Thus, IRS determined that the income tax consequences to a taxpayer of a crowdfunding effort depend on all the facts and circumstances surrounding that effort.[2]

Sales and Use Tax

Though everything is based on a 'facts and circumstance test,' the general rule is that if the donor receives anything of tangible value in return for the donation and the value is above the de-minimis reporting levels currently in place, sales or use tax could apply. The recipient organization would be responsible for reporting and paying the tax.

To date only the State of Washington has issued any official guidance on crowdfunding. But watch for more states to begin issuing similar guidance soon.

[1] However, a voluntary transfer without a "quid pro quo" isn't necessarily a gift for federal income tax purposes.

[2] No cases or IRS rulings directly address the taxability of contributions to a crowdfunding project have occurred to date. Accordingly, whether crowdfunding contributions received are includible in income must be determined by the application of general tax principles.

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This material is presented with the understanding that the author is providing basic information only, and assumes no liability whatsoever in connection with its use. Tax laws are constantly changing, are subject to differing interpretations, and the facts and circumstances in any particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and make sure that you are fully informed and knowledgeable before using the information contained herein.

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