Income, Gift or Deduction?

Hot Topic: Crowdfunding & Your Taxes

By Melinda Nelson, CPA
(480) 839-4900 ~ MelindaN@hhcpa.com

These days, crowdfunding can help pay for almost anything and people are willing to pay up for all kinds of causes near and dear to their hearts. Besides the good feeling of knowing you made a difference in someone's life or the excitement of knowing you helped make a project happen, do you get anything in return – maybe a tax break? After all, charitable donations are deductible. That may be so, but when it comes to the tax code and crowdfunding, you're entering muddy waters.

Can I write off my donation to a crowdfunding campaign?

Sorry to disappoint, but the answer is typically no.

If you're crowdfunding to help a person – paying to help with medical expenses for an illness or to help cover funeral costs – that money is a non-deductible payment because the person you are helping is not a charitable organization.

When you crowdfund a cause for an organization, there is no charitable deduction *unless* the organization is a "*qualified charity*" under the Internal Revenue Code. If the organization is qualified, you would still need a letter of acknowledgement from the organization to be able to deduct your donation.

Maybe your donation is helping to launch a new business that will revolutionize the health care industry. You may view your contribution as a donation or at the very least an investment in the business. However, since you're not receiving equity in return, you don't have an investment so there's no investment deduction available.

I'm setting up a campaign to benefit a friend

If you're trying to do a good deed for someone, you could end up with unexpected tax reporting under your social security number. Kickstarter issues a Form 1099-K, Payment Card and Third Party Network Transactions, to the individual who sets up a crowdfunding campaign on its website. If you are setting up a campaign for someone else – for example, a friend who lost everything in a house fire – you will want to provide Kickstarter with the social security number of the person who is receiving the funds. If you give your social security number, it will look to the IRS like you received the payments and you will have to deal with the reporting of the "income" on your tax return. Leave that task to the person who is actually benefiting from the crowdfunding.

What if I receive money from crowdfunding? Do I have to report it to the IRS?

This is a tricky question. Because the IRS has not released any guidelines on crowdfunding, there are a couple of ways the money could be classified:

- The default position from the IRS is that the money is income, which means you have to report it and pay taxes on it.

- But what if you didn't have any intention to make money? Let's say you're raising funds to pay for your cancer treatment and you made that clear on Kickstarter – Can you argue that the money you receive from others is a gift, which is not taxable income?

Why is this gray area? The current tax law was written over many years and couldn't necessarily foresee a situation in which people give money to other people for, in a lot of cases, absolutely nothing in return. Because crowdfunding is used for so many different purposes and how the money is received is based on each individual situation, it would likely be a difficult task for the IRS to create a general, all-encompassing set of tax rules. For now, most people take a tax position and defend it. Uncertainty will exist until this issue goes to court or the IRS releases guidelines. That could happen sooner rather than later with a case in Nebraska.

According to KETV in Omaha, Casey Charf received $50,000 in donations through a GoFundMe campaign after she was seriously injured in a car crash. The IRS slapped her with a $19,000 tax bill, saying she should have reported the money as income and now owes back taxes, penalties and interest. Charf says the money, which she used to cover the costs of her medical care, is donations, not income. KETV reached out to the IRS, but a spokesperson said law prohibits the agency from talking about specific matters involving taxpayers. Charf is appealing the tax bill.

How should I handle crowdfunding?

Your best bet if you're setting up or getting involved in a crowdfunding campaign, is to talk to your tax professional. He or she can advise you by first identifying what you're doing. Is this a personal campaign? Related to a business? A charity? Those details matter. If it's related to a business, chances are the money received is income, which means you will have to report it on your tax return. If it's for a charity, you'll want to link the campaign to the organization in some way and do your best to get donors a letter of acknowledgement from the charity so they can take a charitable deduction for their contributions.

The second important step your tax professional will take is to help you identify your risk. He or she can then offer alternatives for how to best report the money you will receive.

Melinda Nelson, CPA is a Senior Manager with Henry & Horne, LLP. Her areas of specialization include tax issues for estates, trusts and closely held businesses and their owners. She can be reached at (480) 839–4900 or MelindaN@hhcpa.com.