CROWDFUNDING AGENDA

• What is it?
• How is it being used?
• Why does this matter to me?
• Reporting
• Income Tax Consequences
  • Federal
  • State
• State Sales Tax Consequences
• Q&A
CROWDFUNDING OVERVIEW

• Campaign owner selects crowdfunding platform (i.e., kickstarter.com, indiegogo.com, gofundme.com)
• Campaign owner creates a campaign, telling the story of their product, idea, concept or reason for fundraising
• Third party contributors “contribute” funds to the campaigns
• Funds raised are distributed to campaign owner (less any applicable fees assessed (i.e., by the platform itself, credit card processors, foreign currency conversion, etc.))
• Campaign owner, in exchange for this contribution may:
  • Provide a product
  • Provide a nominal value perk such as a logo tee shirt/tickets to an event

CAMPAIGN LIFE CYCLE

Campaign Owner → Platform (ex., Indiegogo, Kickstarter, Go Fund Me) → Campaign → Contributors
CAMPAIGN FUNDS FLOW

Contributor $ Payment Processor (ex., PayPal, Credit Card Company, Stripe) $ Campaign

CAMPAIGN FUNDS FLOW (CONT’D)

Platform (ex., Indiegogo, Kickstarter, Go Fund Me)

Campaign Owner W-8/W-9 provided

Platform (ex., Indiegogo, Kickstarter, Go Fund Me)

Issued 1099-K on all processed payments (gross)

Payment Processor (ex., PayPal, Credit Card Company, Stripe)

Platform (ex., Indiegogo, Kickstarter, Go Fund Me)

Issued 1099-K (if thresholds met) Shows gross amount of contributions

Campaign Owner
CROWDFUNDING USES

• Means to raise capital on a broad platform from a vast number of diverse parties
  • Raising capital for businesses, individuals, projects, charities, etc.
    • Alternative to venture/early stage capital
    • Raise capital for acquisitions
  • Marketing to gauge interest in an innovation/invention/new product prior to fully investing in the capital for full scale development/production
  • Soliciting funds for personal purposes such as medical, funeral or living expenses
  • Donating to charitable organizations

CROWDFUNDING – WHY DOES THIS MATTER TO ME?

• Increasing popularity of crowdfunding as means to raise funds

• Increased likelihood that clients have initiated one or more campaigns

• Possible client calls with respect to crowdfunding
  • Why is this platform asking that I provide tax information (Form W-9/Form W-8) before giving me these funds that my campaign raised
  • Why did I receive a Form 1099-K
CROWDFUNDING – INFORMATIONAL REPORTING

• Section 6050W and Treas. Reg. Section 1.6050W-1 require payment settlement entities (“PSE”) to file Forms 1099-K
  • PSE includes Third Party Settlement Organization (“TPSO”) that have the contractual obligation to make payment to participating payees of third party network transactions (any transaction settled through third party payment network)

• Form 1099-K De Minimus Threshold by TPSO
  • Transactions exceed $20,000; and
  • Number of transactions exceed 200

• Form 1099-K reports gross amounts

CROWDFUNDING – INFORMATIONAL REPORTING (CONT’D)

• Campaign owner who raised more than $20,000 and had more than 200 transactions (contributions to the campaign) likely issued Form 1099-K with gross amounts reported

• What if campaign owner/taxpayer does not receive or de minimus threshold not met
FEDERAL INCOME TAX CONSIDERATIONS - CROWDFUNDING

• AICPA Task Force inquired with the IRS on whether published guidance on crowdfunding is forthcoming
  • No authority directly addressing crowdfunding
  • Determination under general tax principles
• Office of Chief Counsel 2016-0036 (response to request for an information letter on the tax consequences of crowdfunding to purchase a company, with the possibility of returning funds to contributor)
  • Concluded crowdfunding revenues generally includable in income in accordance with Section 61 unless:
    • Loan to be repaid; capital contribution in exchange for equity interest in such entity; or gift made out of detached and disinterested generosity without any “quid pro quo”
  • Authority under Sections 451 and 461 for determination of year of inclusion and expense deduction, however, consideration under Section 162 and whether taxpayer is engaged in a trade or business

FEDERAL INCOME TAX CONSIDERATIONS - CROWDFUNDING

• Considerations with respect to determining income treatment
  • Section 61 provides that gross income includes all income from whatever source derived
    • Broadly construed and generally extends to all accessions to wealth to which the taxpayer has unmitigated control
• Business
  • Established trade or business
  • Startup
  • Beginning of trade or business for Section 162
    • Taxpayer engaged in trade or business when it has begun functioning as a “going concern and performed the activities for which it was organized.”
      See Richmond Television Corp. v. United States*

*Richmond Television Corp. v. United States, 345 F.2d 901 (4th Cir. 1965), vacated and remanded per curiam on other grounds, 382 U.S. 68 (1965), original holding on this issue affirmed, 354 F.2d 410 (4th Cir. 1965), overruled on other grounds by NCNB Corp. v. United States, 684 F.2d 285 (4th Cir. 1982)
• Hobby
  • Section 183 provides that no deduction under Section 162 or Sections 212(1), 212(2) is allowed for an activity not engaged in for profit
  • Generally, Section 183 does not apply if operations undertaken with an actual and honest profit motive (facts and circumstances)
  • In determining whether activity engaged in for profit, Service considers facts and circumstances such as:
    • Manner in which the taxpayer conducts the activity;
    • Expertise of the taxpayer or his/her advisers;
    • Time and effort taxpayer spent on the activity;
    • Expectation that assets used in the activity may appreciate in value;
    • Taxpayer's success in similar or dissimilar activities;
    • Taxpayer's history of income or losses with respect to the activity;
    • Amount of occasional profits;
    • Taxpayer's financial status; and
    • Elements of personal pleasure or recreation*
      • *No one factor is determinative

*Treas. Reg. Section 1.183-2(b).

• Personal
  • Gift
    • Excluded from income if property transfer made from detached and disinterested generosity, out of affection, respect, admiration, charity, or like impulses, and isn’t made from a moral or legal duty, for anticipated economic benefit, or in return for services rendered. Comm’r v. Duberstein, 363 U.S. 278 (1960).
    • Employer contributed to employee’s personal campaign
    • Annual gift tax exclusion and filing of gift tax returns

• Charitable
  • Verification of organization’s tax-exempt status
  • Person/entity directly raising funds with intent to donate to a charitable organization

*Treasury Regulation Section 1.183-2(b).
FEDERAL INCOME TAX CONSIDERATIONS - CROWDFUNDING (CONT’D)

• Year of income inclusion
  • Section 451 income is generally included in year in which it was received by the taxpayer
    • Consider taxpayer’s method of accounting
      • Treas. Reg. Section 1.451-1(a) accrual method all events have occurred that fix the right to receive such income and the amount of income can be determined with reasonable accuracy.
  • Constructive receipt
    • Credited to account, set apart or drawn upon funds with notice
  • Substantial restrictions imposed on the funds
    • Self-imposed restriction on the funds
      • Will return the funds if a minimum amount of funds are not raised

• Year of deduction
  • Section 461 all events test
  • Costs/expenses associated with perks/rewards or products provided to contributors

CROWDFUNDING – CA – INCOME TAX

• California follows federal treatment of crowdfunding

• California Franchise Tax Board’s position: Without an analysis of the facts and circumstances, tax preparers can advise their clients that in most cases, amounts raised are includable in taxable income unless specifically exempted by law
SALES TAX – IN GENERAL

• Imposed by 46 states including the District of Columbia
• Not imposed in (N.O.M.A.D.)
• New Hampshire
• Oregon
• Montana
• Alaska
• Delaware
• Average sales tax rate in U.S. is 8%

NEXUS – SALES TAX

• Before any state has jurisdiction to impose a tax on a business, there must be at least a minimal connection between the state and the business and/or transaction it seeks to tax
• This minimum connection is often referred to as “nexus”
• The in-state physical presence of a business that is more than a de minimis physical presence generally creates nexus for purposes of sales and use tax
• In general, the out-of-state business must have substantial nexus under the United States Constitution
• Generally, nexus is created by having employee, property, or employee traveling to the state
• Many states take the position that other parties, affiliated or unaffiliated, can create nexus for an out-of-state business in a taxing state
SALES TAX IMPLICATIONS OF CROWDFUNDING
INCLUDING THE TAX TREATMENT OF PROVIDING PERKS
AND GIFTS TO CONTRIBUTORS

• Tangible goods provided in crowdfunding activities can be subject to sales or use tax depending upon whether the items are considered sales or gifts

➢ If an item is sold for an agreed upon price, the tax is calculated on the agreed upon value contributed

➢ If an item is given away as a perk, the tax is due on the cost of the physical item given away

EXAMPLES OF HOW SALES TAX APPLIES TO TANGIBLE GOODS IN CROWDFUNDING

• Selling a tangible product via crowdfunding – sales tax due on the agreed upon sales price

• Giving away a tangible product as a “perk” in return for fundraising – sales tax due on the cost of the item

• Giving away a tangible product “perk” in return for raising money or equity – sales tax due on the cost of the item

• Sales tax will be determined by the language in the agreement and the facts and circumstances
BEST PRACTICES

• Inquire of clients regarding whether they have established campaigns/received funds from crowdfunding
  • Consider adding questions to client organizer

• Inquire if clients have “sold” products in the course of their crowdfunding (i.e., contribute $100 receive X product)
  • If so, what states are involved
  • What costs associated with products

• Inquire if clients have provided a “nominal” value perk in the course of their crowdfunding
  • If so, what states are involved
  • What was the cost of the item

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Questions?