Crowdfunding

2016

www.pwtaxandaccounting.com
(760) 625-5549

PW
Tax and Accounting

Crowdfunding

Crowdfunding is used to solicit financial contributions from a large number of people, referred to as backers, over the internet. The financial contributions are used for a wide variety of projects including business ventures, social causes, and support for individuals with a special need. By using the internet, projects can gain access to funds outside of traditional sources such as banks or capital markets. A number of organizations, referred to as platforms, have developed to connect someone seeking funds with those who have an interest in contributing. The use of crowdfunding has developed rapidly in the last twenty years with billions of dollars being raised each year by this method and hundreds of projects being launched on a daily basis.

Typical Projects

Crowdfunding for creative efforts such as music, gaming, and movie projects have raised some of the largest amounts of money. High tech projects are also very common. Some examples include Pebble E-Paper Watch, Formlabs 3D Printer, and Oculus Rift. The Tile app for finding lost items received support from crowdfunding. The ALS (amyotrophic lateral sclerosis) Ice Bucket challenge is an example of a recent highly successful campaign to raise money to battle an incurable disease.

Crowdfunding a Project

Project Initiator. The individual or organization, referred to as a project initiator, seeking to fund a project determines the funding need and deadline, selects the platform most suited to the project, and creates a presentation to attract backers.

Platform. The platform makes the presentation available to a large number of backers via the internet and may provide other services to the project.

Backers and Pledges. Interested backers are able to make pledges using a credit card. The organization serving as the platform will typically use a company such as Paypal or Amazon Payments to collect and release the funds. The release of funds is based on either the All or Nothing or Keep it All method.

All or Nothing. Funds are released to project and backer credit cards are charged only if the funding goal is met by the deadline.

Keep it All. In this case, funds are released to the project and credit cards are charged when the deadline occurs. The project initiator decides whether to proceed with the project with partial funding or return the pledges.

Crowdfunding Platforms

There are hundreds of platforms available to project initiators. Some of the larger or more well-known platforms are Kickstarter, Indiegogo, Crowdfunder, Rockethub, Crowdrise, and appbackr. Due diligence on the part of the project initiator is necessary to find the platform most suited to a particular project and avoid scams or other issues. The focus for these platforms is summarized below:

Platform	Project Focus
Kickstarter	Creative projects
Indiegogo	All types
Crowdfunder	Investment
RocketHub	Creative projects desiring follow-on support
Crowdrise	Causes and charities
appbackr	Mobile apps

Crowdfunding

Fees. The platform will typically receive 3% to 5% of the funds raised. The company holding and paying out the funds will typically charge 3% to 5% of the funds.

Backer Involvement

Crowdfunding offers potential backers the opportunity to search for a wide variety of projects that appeal to them. Backers receive the satisfaction of donating to a project with a relatively small donation that is easily made.

Rewards or payoff. In addition to the satisfaction of giving, the backer may receive something in return with no or very little monetary value up to a stake in the company.

Risks. Backers run the risks of scams and no pay-off from an investment in a high risk project. Due diligence can be very difficult to perform. If the funds are released on an All or Nothing basis, then backers will see a credit card charge for projects that do not reach their funding goal. If funds are released on a Keep it All basis, then the backer must rely on the project initiator to return unused funds.

Tax Issues

Crowdfunding can create a number of tax issues. In some cases, there is little guidance from the IRS or state governments on how to treat the transactions.

Tax deductions. Generally, contributions to a crowdfunded project will not be deductible unless the project is a qualified charity. Contributions to an individual are not deductible.

Gift tax. Unless the backer makes a very large gift (over $14,000 in 2015) or has made other large gifts, a gift tax return will not be required.

Capital gains/losses. If the backer receives shares in a company, then a record of the basis of the shares and date(s) acquired must be kept. A capital gain or loss will occur when the shares are disposed of or in the event of a project failure.

Loans. If the backer receives interest from a loan to a project, then the interest will need to be reported. In the event of a project failure, the backer may be able to deduct the loan as a bad debt.

Taxable income. When an individual or nonprofit cause receives a gift, the income is generally not taxable to the recipient. Depending on the amount received and the number of backers, the recipient may receive a Form 1099-K, *Payment Card and Third Party Network Transactions,* from the IRS. The individual will need to consider how to inform the IRS that these funds are a gift and not income. A nonprofit will have to consider whether to file for exempt status and whether to file a 990 series tax return.

A business receiving pledges will need to determine if these pledges are taxable income or nontaxable gifts.

Self-employment tax. A business operating as a sole proprietorship that has taxable income will owe self-employment tax on the income.

Sales tax. A business providing a product to backers in return for a donation may owe sales tax in the states where the backers reside. Sales tax rules vary widely from state to state.

Summary

Crowdfunding is a new, exciting, and successful method of raising funds for individuals in need, causes with social value, and business start-ups. Individuals and causes are able reach a large number of potential donors. Businesses are able to raise funds outside of more complex and expensive methods in the traditional banking and capital markets. Backers can select from a wide range of projects that they may wish to contribute to.

On the other hand, crowdfunding raises business, legal, and tax issues where the rules have not been firmly established. In many cases, the project initiators may not be fully aware of these issues until after funds have been raised and tax returns need to be filed.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.