

GoFundMe, Taxable Income vs. Tax Free Gift

Cross References

- IRC §102

This article is one in a series of new articles designed to help answer tax questions that have been recently posted to our message board. The message board at thetaxbook.com allows participants to ask fellow tax preparers questions about their client's tax issues. In each article, we highlight a particular message board question that is a current relevant topic, and provide our own research and opinion that may be helpful for the tax preparer community.

Message Board Question

In this article, the question has to do with whether or not money received from a GoFundMe online fundraising campaign is taxable income to the recipient, or tax free as a gift. To highlight the issue, a link was provided to a real life example. The taxpayer was a survivor of a terrible car crash in which she suffered a broken neck and back. During tests and scans to determine the extent of her injuries, doctors discovered cancer tumors hidden throughout her body. She had no idea prior to the accident that she had cancer.

Her story went viral, and her sister set up a GoFundMe account online to solicit donations to help with expenses, which raised about \$50,000. Thinking the money was a tax-free gift, the taxpayer never reported this as income on her tax return. Two years later, the IRS sent a letter saying she owed \$20,000 in taxes, which consisted of \$15,457 in back taxes and \$3,676 in penalties and interest.

Crowdfunding

Crowdfunding is the practice of soliciting financial contributions from a large number of people over the internet. The financial contributions are used for a variety of projects including business ventures, social causes, and support for individuals with a special need. By using the internet, individuals and organizations can gain access to funds outside of traditional sources such as banks or capital markets. A number of organizations 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 20 years with billions of dollars being raised each year and hundreds of projects being launched on a daily basis. The website www.gofundme.com is one of many examples of crowdfunding.

Crowdfunding raises a number of tax questions, including:

- *Taxable income or tax-free gift?* Is the money raised taxable income or considered a tax-free gift to the one who receives the funds?
- *Are donations deductible as charitable contributions?* If someone donates money to a crowdfunding campaign, is the donation tax deductible?

- *How to handle the Form 1099-K?* If the crowdfunding organization issues a Form 1099-K to the one who sets up the account, how should that information be reported on the tax return?
- *Is it subject to gift tax?* If someone sets up a crowdfunding account for the benefit of someone else, is that individual subject to gift tax when transferring the funds to the recipient?
- *Is it deductible as medical expenses?* If money raised is used to help pay for medical bills, is the recipient of those funds able to deduct as itemized deductions those medical expenses?

Taxable Income or Tax-Free Gift?

Unless there is a specific exclusion, all income from whatever source derived is taxable. One exclusion is that gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. The code and regulations do not define the term “gift,” however, they do provide some examples. An amount of principal paid under a marriage settlement is a tax free gift, except for any amount that meets the definition of alimony. The term gift also does not include prizes and awards, except for certain employee achievement awards. A gift from an employer to an employee is taxable, unless it meets the definition of a de minimis benefit, such as a holiday gift that is not in cash and has a low fair market value.

It is important not to confuse this issue with the deductibility of charitable contributions. Online fundraising websites such as GoFundMe are usually not recognized as qualified charitable organizations. Thus, a donation to a GoFundMe account for the benefit of someone in need is not deductible as a charitable contribution. That fact, however, should have no bearing on whether the funds raised are taxable to the recipient. A parent, for example, is not a tax-exempt charity. Yet there is no question that cash gifts from a parent to a child are tax free to the child.

With little guidance from the code and regulations, it is necessary to look to the courts for the definition of a tax free gift. In *Berst*, T.C. Memo. 1997-137 (March 17, 1997), the Tax Court stated property is considered a gift if given in a spirit of detached and disinterested generosity.

In *Caracci*, 118 T.C. No. 25 (May 22, 2002), the Tax Court stated that when property is transferred for less than adequate and full consideration in money or money’s worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

In *Hamlett*, T.C. Memo. 2004-78 (March 22, 2004), the Tax Court stated a gift is a transfer of property that proceeds from a detached and disinterested generosity, out of affection, respect, admiration, charity, or like impulses. The transferor’s intent in making the transfer is the most critical consideration in determining whether the property transferred was a gift.

In *Hatch*, T.C. Memo. 2012-50 (February 23, 2012), while acknowledging that transfers by or for an employer to an employee are not excludible from income, the Tax Court noted

that in exceptional circumstances, a transfer between an employer and an employee may be considered a gift. The legislative history indicates that a gift may be made by an employer to an employee if it is exclusively for personal reasons, if it is entirely unrelated to the employment relationship, and if it reflects no anticipation of business benefit.

Usually, in the case of an online solicitation through GoFundMe to help with the medical expenses for someone in need, the one making the donation:

- Does not receive any consideration in money or money's worth in exchange for the donation,
- Is not an employer of the one receiving the donation and is not expecting some anticipated business benefit for making the donation, and
- Most likely is motivated to make the donation out of some charitable, detached, disinterested generosity.

Consider the intent of the donation is to help someone in need, motivated by a charitable impulse. The donor does not expect any kind of consideration or benefit in return, other than the sense of being generous and charitable.

Based on the language used by the courts to describe a tax free gift, funds received through an online fundraising campaign to help pay for medical expenses, such as donations solicited through a GoFundMe account, appear to meet the definition of gifts under the Internal Revenue Code, and would not be taxable to the recipient.

This does not mean that every GoFundMe campaign donation qualifies as a gift. The issue could be entirely different if, for example, the person soliciting donations through GoFundMe is a famous musician seeking fan support to pay his personal debts. Facts and circumstances could indicate such donations are motivated by some factor other than charitable support for a disadvantaged individual, and as such would not be considered tax-free gifts.

It is generally understood that funds raised to support a profit motive, such as a business, are taxable to the recipient. Normally, money given to a business is not motivated by a charitable, detached, disinterested generosity on the part of the donor. For example, if a business sets up a GoFundMe account and solicits donations due to poor economic conditions, the donations are likely used to help pay for business expenses and as such are tied to a profit motive rather than helping with a charitable need.

Are Donations Deductible as Charitable Contributions?

A charitable contribution is a donation or a gift to, or for the use of, a qualified organization. It is voluntary and is made without getting, or expecting to get, anything of equal value. Subject to certain limits, conditions, and reporting requirements, a charitable contribution can be deducted by the donor on Schedule A (Form 1040). Qualified organizations include nonprofit groups that are religious, charitable, educational, scientific, or literary in purpose, or that work to prevent cruelty to children or animals. Thus, in order for a donation to a crowdfunding campaign to be tax deductible, the organization that receives the donations must be a qualified charitable organization. Usually if this is the case, the crowdfunding website would have information available that identifies the tax-

exempt organization as a qualified charitable organization, resulting in a tax deduction for the donor.

It should be noted that gifts to individuals are never deductible as charitable contributions, even if the individual is associated with a charitable organization. For example, making a gift of money directly to a minister to perform a marriage ceremony or funeral at a church is not deductible as a charitable contribution because the donation is going to an individual rather than the church. To be deductible, the donation should be made to the church, and the church in turn decides what to pay the minister performing the services. This is why a crowdfunding account set up to help a specific individual in need is probably not associated with a charitable organization. Organizations seeking tax-exempt status generally have to be organized for some form of community benefit and are not allowed to be set up solely to help a specific individual with a specific need.

How to Handle the Form 1099-K?

Money raised through a crowdfunding campaign is usually paid to the one who created the account using a third party settlement organization, such as PayPal or Amazon Payments. These third party settlement organizations are required to issue Form 1099-K, *Payment Card and Third Party Network Transaction*, to the recipient of these funds if the gross amount of total reportable payment transactions exceeds \$20,000 and the number of transactions exceeds 200. Usually the crowdfunding website and the third party payment organization charges a fee based upon the amount of funds that are raised during the campaign. The tax preparer should inquire as to whether or not these fees are reflected in the amount reported on the Form 1099-K.

However, just because something is reported on Form 1099 does not mean the transaction is taxable. The first question that must be answered is whether the donations are taxable to the recipient, or tax-free as a gift. That in turn determines how to handle the Form 1099-K.

Author's Comment

If a Form 1099-K is issued for money that is exempt from tax, the amount could be reported on the return (as other income, line 21, Form 1040), followed by a negative number in the same amount with a statement attached to the return explaining why the income is not taxable. For example, a statement could say:

"All of the funds reported on Form 1099-K were received by the taxpayer as a result of gifts from generous donors to help pay the medical expenses of the taxpayer, and as such are excludable from gross income under Internal Revenue Code section 102."

Are Donations Subject to Gift Tax?

Federal gift tax applies to the giver of the gift, not the recipient of the gift. Thus, unless someone donates more than the annual exclusion amount to any one recipient during

the year (\$14,000 for 2016), the federal gift tax should not have any consequence to the one making a crowdfunding donation.

What could be an issue is if the crowdfunding account is set up by someone other than the one who is to receive the funds. Collecting all of the funds, and then giving those funds to the recipient, could require the filing of a gift tax return, if the total amount raised exceeds the \$14,000 annual exclusion.

However, there are some exceptions to the gift tax rules. The following types of gifts are not subject to the federal gift tax:

- Giving money to help pay for someone's tuition and medical expenses.
- Giving money to a spouse.
- Giving money to a political organization.
- Giving money to a qualified charity is reported on the gift tax return, but the value of the gift is then taken as a deduction against total gifts.

Are Gifts Deductible as Medical Expenses?

If money received as gifts is used to help pay for medical bills, is the recipient of those funds able to deduct as itemized deductions those medical expenses? The simple answer is, yes, for the money that is actually used to pay for medical expenses. The amount used to help pay for other personal living expenses is not deductible, even if the donor contributed the funds to help pay for medical expenses. There is no tracing rule under IRC section 213 that requires tracing the source of the funds to some taxable source before being able to deduct the expense as a medical expense.

