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The Tax Implications of Crowdfunding: From Income to Deductions

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INTRODUCTION

Over the past few years there have been countless crowdfunding success stories. Perhaps one of the most notable occurred during the fall of 2017 when NFL star J.J. Watt raised over $37 million to aid those affected by Hurricane Harvey.[1] He accomplished this feat through YouCaring, a crowdfunding website.[2] Over 200,000 people gave money via the YouCaring page.[3] Crowdfunding, however, is used not only by celebrities but also by everyday people to raise money for their various causes or products. For example, another success story occurred in the fall of 2016 when Khaled Majouji set up a crowdfunding page through GoFundMe, another crowdfunding website, to raise money for his new business that revolves around an emerging farming technique.[4] Majouji raised over $230,000 through his efforts.[5] Additionally, a crowdfunding page was recently set up for a man named Scott Lamaster through GoFundMe to raise $15,000 for medical bills related to a propane grill accident.[6] These are just some of the many crowdfunding attempts made in recent years.[7]

1. Tyler Conway, *J.J. Watt's Hurricane Harvey Fundraiser Closes with over $37M in Donations*, BLEACHER REP. (Sept. 15, 2017), http://bleacherreport.com/articles/2733472-jj-watts-hurricane-harvey-fundraiser-closes-with-over-37m-in-donations [https://perma.cc/PD7C-ECJW].

2. *Id.*

3. *Id.*

4. Khaled Majouji, *In.Genius's Farming Revolution Fund*, GOFUNDME (Aug. 1, 2016), https://www.gofundme.com/2hgyjcs [https://perma.cc/WFA5-9ZAN].

5. *Id.*

6. Janna Jensen, *Medical Bills for Scott Lamaster*, GOFUNDME (Dec. 2, 2017), https://www.gofundme.com/medical-bills-for-scott-lamaster [https://perma.cc/N34J-234J].

7. Since this Recent Development was originally drafted, the media has highlighted several other notable crowdfunding efforts. Juli Briskman, who was fired from her job for giving the middle finger to President Trump, benefitted from a crowdfunding page that raised over $30,000 to pay for Briskman's legal bills. Brandon Carter, *More than $30k Raised for Woman Fired for Flipping Off Trump Motorcade*, THE HILL (Nov. 9, 2017, 7:45 PM), https://thehill.com/blogs/blog-briefing-room/news/359727-crowdfunding-campaign-raises-over-30k-for-woman-fired-for [https://perma.cc/3RNM-BBRP]. Dr. Christine Blasey Ford, after she testified before the Senate in relation to Justice Kavanaugh's nomination and confirmation, benefitted from several GoFundMe pages that raised more than $500,000 for security, advertisement, and personal expenses. Ari Levy, *GoFundMe*

Accompanied by a long list of concerns surrounding crowdfunding,[8] two basic tax issues remain unanswered. First, is the money raised by J.J. Watt, Khaled Majouji, and Scott Lamaster subject to federal taxation? Second, if that money is later contributed to a charity, used for medical expenses, or used for an ordinary and necessary business expense, is the taxpayer[9] allowed to take a tax deduction?

Neither the Internal Revenue Code (the "Code") nor the Internal Revenue Service ("IRS") has directly addressed these issues.[10] In fact, "[n]o court cases, regulations, or revenue rulings directly address the issue of crowdfunding contributions as gross income."[11] The only guidance the IRS has provided is a nonbinding information letter that simply draws attention to the longstanding principles of tax law.[12] This lack of guidance means that taxpayers

Campaigns Have Raised More than $500,000 to Cover Blasey Ford's Costs, CNBC (Sept. 27, 2018, 2:57 PM), https://www.cnbc.com/2018/09/27/gofundme-campaigns-raised-over-500000-to-cover-blasey-ford-costs.html [https://perma.cc/J68A-Z5J4]. After tragedy struck the Humboldt junior hockey team and fifteen members were killed in a bus accident, a GoFundMe page was set up to benefit the players and their families which raised over $4 million. Steve Gardner, *Humboldt Junior Hockey Team GoFundMe Benefit Tops $4 Million in Donations*, USA TODAY SPORTS (Apr. 8, 2018, 10:02 PM), https://www.usatoday.com/story/sports/hockey/2018/04/08/humboldt-junior-hockey-team-benefit-tops-4-million-donations/497921002/ [https://perma.cc/PRX5-FTM5]. Several GoFundMe pages were set up recently after the volcano eruption in Hawaii. *See, e.g.*, Colleen An Joshua Block, *Block Family & Business Displaced*, GOFUNDME (May 4, 2018), https://www.gofundme.com/the3blocks [https://perma.cc/ZT5S-BER3] (raising over $25,000 for the Block family). Further, several crowdfunding pages were set up to help victims of the wildfires that hit California during the summer of 2018, including one that helped firefighters who lost their homes. Amanda del Castillo, *Bay Area Fire Association Creates GoFundMe for Heroic Redding Firefighters Who Lost Homes*, ABC 7 NEWS (Aug. 3, 2018), https://abc7news.com/bay-area-fire-association-creates-gofundme-for-heroic-redding-firefighters-who-lost-homes/3879951/ [https://perma.cc/UUV6-VZHZ]. Finally, several GoFundMe pages were set up to help those who were impacted by Hurricane Florence and Hurricane Michael. *See, e.g.*, Task Force 75, *Task Force 75 Hurricane Response*, GOFUNDME (Sept. 9, 2018), https://www.gofundme.com/task-force-75-hurricane-florence [https://perma.cc/6L2Q-ANSE] (raising $18,000 to help a disaster response team).

8. *See infra* note 35.

9. Here, the "taxpayer" is the individual who sets up the crowdfunding website and subsequently takes a deduction.

10. Cheryl T. Metrejean & Britton A. McKay, *Crowdfunding and Income Taxes*, J. ACCT. (Oct. 1, 2015), https://www.journalofaccountancy.com/issues/2015/oct/crowdfunding-and-income-taxes.html [https://perma.cc/QJL4-SWHU].

11. Cathalene Bowler & Dennis Schmidt, *Crowdfunding: Tax Issues and Strategies*, 99 PRAC. TAX STRATEGIES 20, 21 (2017).

12. *Id.* ("An information letter calls attention to a well-established interpretation or principle of tax law. It is advisory only and has no binding effect on the IRS.").

must rely on general tax principles to determine whether the money raised through crowdfunding is subject to federal taxation.[13]

In addition to the lack of guidance on the receiving end of contributions from crowdfunding, even less guidance exists on the subsequent expensing of those same contributions. Can taxpayers who raise money through donations-based crowdfunding take a charitable deduction once that money is donated? Can those same taxpayers take a medical expense deduction or a business deduction?

This Recent Development analyzes these two broad tax issues. Part I generally describes the four different types of crowdfunding. Part II analyzes whether money raised through rewards-based crowdfunding and donations-based crowdfunding are subject to federal taxation. Finally, Part III analyzes whether money raised through donations-based crowdfunding can subsequently be deducted, lowering a taxpayer's liability further.

I. TYPES OF CROWDFUNDING

Crowdfunding is a popular "method of collecting many small contributions, by means of an online funding platform, to finance or capitalize a popular enterprise."[14] Crowdfunding became popular in the United States in 2003 after a Boston musician launched ArtistShare.[15] The first crowdfunding project launched on ArtistShare was wildly successful, raising around $130,000 for the production of a jazz album.[16] The album, *Concert in a Garden*, went on to win a Grammy in 2005.[17] This success led to many other crowdfunding campaigns and the launch of other crowdfunding platforms.[18]

The popularity of crowdfunding has led to the development of four unique types of crowdfunding: (1) rewards-based crowdfunding, (2) donations-based crowdfunding, (3) equity crowdfunding, and (4)

13. This Recent Development focuses solely on the effect crowdfunding has on federal income tax. It does not analyze crowdfunding's effect on other tax regimes, such as sales tax, gift tax, or estate tax.

14. DAVID M. FREEDMAN & MATTHEW R. NUTTING, A BRIEF HISTORY OF CROWDFUNDING: INCLUDING REWARDS, DONATION, DEBT, AND EQUITY PLATFORMS IN THE USA 1 (2015), https://www.freedman-chicago.com/ec4i/History-of-Crowdfunding.pdf [https://perma.cc/67QW-48AY].

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 2.

debt crowdfunding.[19] Each one of these offers a unique twist on how to raise funds for a project or cause.

A rewards-based crowdfunding scheme occurs when backers contribute "small amounts of money . . . in exchange for a reward."[20] A typical example of a rewards-based crowdfunding scheme is the jazz album, *Concert in a Garden*, for which donors received a variety of incentives depending on the donation amount, ranging from an early download of the album to being listed as an executive producer.[21] With rewards-based crowdfunding schemes, not all donors necessarily get a reward. This is because, in the instances where rewards are available, many supporters pledge small amounts that are not enough to qualify for a reward.[22] These small donations are likely given not for a tangible reward but rather because donors support the project or product.[23]

Donations-based crowdfunding occurs when donors contribute money to a project creator or beneficiary, receiving only gratitude in return.[24] Donations-based crowdfunding is often utilized by nonprofits for noble causes, such as building schools or providing water for communities in developing countries.[25] Donations-based crowdfunding allows both individuals and large charitable organizations to solicit donations from a wide array of places, individuals, and organizations.[26] A classic example of donations-based crowdfunding is J.J. Watt's effort, which raised more than $37 million for Hurricane Harvey relief.[27] Other examples include a local sports team raising money for the opportunity to travel to a championship tournament or a high school group raising money to travel abroad.[28]

19. Clay Hebert, *The Different Types of Crowdfunding (and Which Is Right for You)*, CROWDFUNDING HACKS (June 2, 2015), http://crowdfundinghacks.com/different-types-of-crowdfunding/ [https://perma.cc/U42U-FYHZ].

20. *Id.* (emphasis omitted).

21. FREEDMAN & NUTTING, *supra* note 14, at 1 ("[The artist] offered a tiered system of rewards. For a $9.95 contribution, for example, a backer got to be among the first customers to download the album upon its release in 2004. Fans who contributed $250 or more (in addition to receiving an album download) were listed, in the booklet that accompanied the album, as participants who 'helped to make this recording possible.' One fan who contributed $10,000 was listed as executive producer.").

22. *Id.* at 2.

23. *Id.*

24. Hebert, *supra* note 19.

25. *Id.*

26. FREEDMAN & NUTTING, *supra* note 14, at 5.

27. Conway, *supra* note 1.

28. FREEDMAN & NUTTING, *supra* note 14, at 5.

Equity crowdfunding occurs when investors give money and, in return, receive a portion of ownership in the company.[29] Equity crowdfunding is typically used to "fund the launch or growth of a company, not just initiate a creative project or cause."[30] This is a streamlined process for an entrepreneur to find investors. It potentially turns a process that could ordinarily take eight to twelve months into one that lasts for only a few weeks, days, or even hours.[31]

Lastly, debt crowdfunding has lenders rather than donors or backers.[32] The lenders do not get a reward or piece of equity in a company but instead make a loan with the expectation of being paid back principal plus interest.[33] Debt crowdfunding is a way to expand the pool of potential lenders beyond traditional lenders, such as banks. Debt crowdfunding "can be used to raise money for [a lot] of reasons, like credit card refinancing, debt consolidation, home improvement, a car or other reasons."[34]

Several potential issues may arise when an individual raises funds through one of these four methods.[35] This Recent Development,

29. Hebert, *supra* note 19. Equity "is the residual interest in the assets of an entity that remains after deducting its liabilities." J. DAVID SPICELAND, JAMES F. SEPE & MARK W. NELSON, INTERMEDIATE ACCOUNTING (7th ed. 2013), *as reprinted in* E. CAROLINA UNIV., ACCT 3551, at 25 (Heather Willison ed., 2013). When someone invests assets in a company, they receive equity, or ownership, in the company. *See id.*

30. Hebert, *supra* note 19.

31. FREEDMAN & NUTTING, *supra* note 14, at 5.

32. Hebert, *supra* note 19. "Debt is an amount of money borrowed by one party from another." *Debt*, INVESTOPEDIA, https://www.investopedia.com/terms/d/debt.asp [https://perma.cc/RT29-89EY]. The difference between making an equity investment and a debt investment is straightforward. An equity investment occurs when a person gives a company money or other assets in exchange for a percentage of ownership of that company. Jared Hecht, *Debt vs. Equity Financing: Which Way Should Your Business Go?*, ENTREPRENEUR (July 19, 2016), https://www.entrepreneur.com/article/278430 [https://perma.cc/DJZ5-8K49]. For example, buying stock in a corporation is an "equity investment." *See id.* By contrast, a debt investment occurs when a person gives a company money or other assets that the company has to pay back after a certain amount of time. *Id.* For example, loaning a company money to be paid back with interest is a debt investment. *Id.*

33. Hebert, *supra* note 19.

34. *Id.*

35. *See* Paul Battista, *The Taxation of Crowdfunding: Income Tax Uncertainties and a Safe Harbor Test to Claim Gift Tax Exclusion*, 64 U. KAN. L. REV. 143, 145 (2015) (proposing a safe harbor test for crowdfunding in order to determine whether money raised is considered a gift); C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 6–7, 9 (addressing two issues that crowdfunding raises: (1) registration requirements of the Securities Act of 1933 and (2) whether websites are considered brokers because they facilitate crowdfunding); Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1740 (2012) (describing securities regulations that affect crowdfunding); Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015

however, will focus only on rewards-based crowdfunding and donations-based crowdfunding[36] and the interesting tax questions that they present. With billions of dollars raised,[37] the tax implications of crowdfunding are becoming increasingly important. The lack of government guidance is surprising, but it leaves room for taxpayers to take advantage of the potential tax benefits and current tax structure. The next section of this Recent Development addresses whether money raised through rewards-based crowdfunding and donations-based crowdfunding is subject to federal taxation.

II. THE AGE-OLD QUESTION: IS THIS TAXABLE?

A. The Legal Authority

Binding legal authority directly addressing crowdfunding is virtually nonexistent.[38] "No court cases, regulations, or revenue rulings directly address the issue of crowdfunding contributions as gross income."[39] When no binding legal authority directly addresses a tax issue, practitioners must rely on core tax principles and related authority.[40]

Though there is no direct provision addressing crowdfunding, the Code is still the best place to start when analyzing the tax implications of crowdfunding. Section 61(a) of the Code states that "gross income means all income from whatever source derived."[41] This statute is

U. ILL. L. REV. 217, 221 (discussing not only how crowdfunding is an attractive new-age IPO but also how it comes with certain risks that entrepreneurs should be aware of before raising funds through crowdfunding); Andrew A. Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 612 (2015) (addressing problems raised by other commentators relating to crowdfunding); Max E. Isaacson, Comment, *The So-Called Democratization of Capital Markets: Why Title III of the JOBS Act Fails to Fulfill the Promise of Crowdfunding*, 20 N.C. BANKING INST. 439, 440–41 (2016) (describing the effects of the JOBS Act on crowdfunding). *See generally* Jamie Drennen, Note, *An Analysis and Prediction of Federal Taxation as It Pertains to Crowdfunding*, 19 DUQ. BUS. L.J. 144 (2017) (addressing taxation issues that arise when a friend begins crowdfunding for another friend and predicting how the IRS may rule on crowdfunding matters in the future).

36. Equity crowdfunding and debt crowdfunding offer their own unique tax questions. These types of crowdfunding, however, are not the subject of this Recent Development.

37. *See Volume of Funds Raised Through Crowdfunding Worldwide in 2017, by Region*, STATISTA, https://www.statista.com/statistics/946659/global-crowdfunding-volume-worldwide-by-region/ [https://perma.cc/43QA-AJGS (dark archive)].

38. Bowler & Schmidt, *supra* note 11, at 21.

39. *Id.*

40. Legal authorities include the Code, Treasury Regulations, Revenue Rulings, Revenue Procedures, Private Letter Rulings, and court opinions.

41. I.R.C. § 61(a) (Supp. 2017).

read very broadly. The Supreme Court stated in *Commissioner v. Glenshaw Glass Co.*[42] that Congress, in defining "gross income," intended to exert "the full measure of its taxing power."[43] *Glenshaw Glass* also stated that Congress intended to tax all gains except those specifically exempted.[44] In short, if a taxpayer receives anything of value, it is subject to federal taxation unless a specific provision of the Code explicitly excludes that source or type of income.

One provision that explicitly excludes a type of income is § 102(a),[45] which states that "[g]ross income does not include the value of property acquired by gift."[46] Whether a transaction is characterized as a gift is a threshold question that determines whether § 102 applies. Unfortunately, there is no bright-line rule for what qualifies as a gift, and the question often turns on the facts of the transaction.[47]

Commissioner v. Duberstein[48] is the leading case in this area of tax law.[49] In that case, Berman gave Duberstein a Cadillac.[50] In the past, Duberstein had given Berman a potential list of customers for Berman's work.[51] Duberstein did not ask for additional payment for this customer list, but Berman insisted that Duberstein accept the Cadillac as a thank you for this list of potential customers.[52] Duberstein hesitantly accepted.[53] Duberstein testified that he did not think he would have received the car from Berman had he not provided him with information regarding his customers.[54] Berman later deducted the value of the Cadillac as a business expense on his corporate income tax return.[55]

42. 348 U.S. 426 (1955).
43. *Id.* at 429 (internal citations omitted).
44. *Id.* at 430.
45. I.R.C. § 102(a) (2012).
46. *Id.*
47. *See* Comm'r v. Duberstein, 363 U.S. 278, 284 (1960).
48. 363 U.S. 278 (1960).
49. J. MARTIN BURKE & MICHAEL K. FRIEL, UNDERSTANDING FEDERAL INCOME TAXATION 52 (5th ed. 2016) ("The leading case in this area is the Supreme Court decision in *Commissioner v. Duberstein*.").
50. *Duberstein*, 363 U.S. at 280.
51. *Id.*
52. *Id.*
53. *Id.* at 280–81 ("Berman insisted that Duberstein accept the car, and the latter finally did so, protesting however that he had not intended to be compensated for the information. At the time Duberstein already had a Cadillac and an Oldsmobile, and felt that he did not need another car.").
54. *Id.* at 281.
55. *Id.*

The Court stated that "the statute does not use the term 'gift' in the common-law sense."[56] A voluntary transfer of property to another without consideration is not necessarily a "gift" within the terms of the statute.[57] The lack of legal or moral obligation does not establish that a transaction is a gift.[58]

Rather, "[a] gift in the statutory sense . . . proceeds from a 'detached and disinterested generosity,' 'out of affection, respect, admiration, charity or like impulses.'"[59] The Court continued, stating that when assessing if a transaction is a gift, the transferor's intention is the most important factor.[60] Thus, the controlling fact is whatever the transferor intended at the time the payment was made, regardless of how voluntary.[61]

The Court emphasized again that the inquiry of whether a transaction is a gift is necessarily fact intensive and is analyzed on a case-by-case basis.[62]

> The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations . . . confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact.[63]

The Court ultimately determined that Berman's "gift" to Duberstein was not a gift under § 102 and therefore was subject to federal taxation.[64] This is because the "gift" was only an attempt to compensate Duberstein for past services rendered or to encourage him to provide more service in the future.[65]

Though the court system has not directly addressed crowdfunding, cases considering the taxability of revenue raised by

56. *Id.* at 285.

57. *Id.* This type of transaction, though, would be considered a common law gift. *Id.*

58. *Id.* For example, a restaurant patron is not legally obligated to tip the waiter. The patron only legally has to pay for the food that the patron ate. Money that is received as a tip, however, is still considered income. *See id.* at 285 n.7 (citing Roberts v. Comm'r, 176 F.2d 221, 222–23 (9th Cir. 1949)).

59. *Id.* at 285 (citation omitted) (first quoting Comm'r v. LoBue, 351 U.S. 243, 246 (1956); and then quoting Robertson v. United States, 343 U.S. 711, 714 (1952)).

60. *Id.* at 285–86 (citing Bogardus v. Comm'r, 302 U.S. 34, 43 (1937)).

61. *Id.* at 286. The Court went on to state that there is no simple test and it will not try to incorporate corporation law principles into tax cases to determine an outcome. *See id.* at 288–89.

62. *Id.* at 289.

63. *Id.*

64. *Id.* at 291–92.

65. *Id.*

panhandling draw a parallel to the taxability of money raised through certain types of crowdfunding.[66] The Tax Court previously held that money received from panhandling is a gift[67] because the proceeds are from "detached and disinterested generosity . . . out of affection, respect, admiration, charity or like impulses."[68] The Tax Court, however, has also implied that if panhandling is a taxpayer's trade or business, that income would be subject to federal taxation.[69]

The IRS released a nonbinding general information letter addressing crowdfunding in June of 2016.[70] This letter, however, only addresses well-established tax principles and does not apply these principles to any specific fact pattern.[71] The IRS wrote that under § 61, income includes anything of value from whatever source derived.[72] It goes on to write that unless the income is specifically excluded by another provision, it should be included in the taxpayer's gross income.[73]

The statutes, court cases, and general information letter provide the basis for the subsequent analysis of whether crowdfunding revenue is subject to federal taxation. The next section will apply this legal authority to determine whether money raised through rewards-based crowdfunding or donations-based crowdfunding is subject to federal taxation.

B. Applying Legal Authority to Rewards-Based and Donations-Based Crowdfunding

1. Rewards-Based Crowdfunding

When a taxpayer raises money through a rewards-based crowdfunding platform, as a general rule, the money raised should be subject to federal taxation.[74] For example, Taxpayer *A* uses a crowdfunding website to raise money for the production of an album.

66. Donations-based crowdfunding is analogous to panhandling, as both occur when an individual solicits donations from a crowd and relies on the generosity of other individuals to donate money to their cause. *See supra* text accompanying notes 24–28.

67. Lucas v. Comm'r, 1999 T.C.M. (RIA) ¶ 99,321, at 1999 (1999).

68. *Id.* (quoting *Duberstein*, 363 U.S. at 285).

69. Basada v. Comm'r, 1998 T.C.M. (RIA) ¶ 98,144, at 802 (1998) (stating that "street hustling," which includes panhandling, can be a trade or business if done with continuity and regularity, and with the primary objective of earning an income or profit).

70. I.R.S. Info. Ltr. 2016-0036 (June 24, 2016), 2016 WL 6664847.

71. *Id.*

72. *Id.*

73. *Id.*

74. *See supra* text accompanying notes 41–44.

To encourage "donations," individuals who give $10 will receive a first edition album. Individual *B* donates $10 and then receives an album.

When Taxpayer *A* receives $10, under § 61(a), he has received something of value. This money should be subject to federal taxation unless there is another provision specifically excluding it.[75] No such provision exists.[76] Section 102 would not apply here because Individual *B* is not simply giving to charity. Though Individual *B* may be buying this album solely because Taxpayer *A* is his friend, the fact that Individual *B* received an album, or something of value, makes this a quid pro quo, and it would therefore not be considered a gift.

A different issue appears if the facts of the above example are changed slightly. Instead of Individual *B* giving $10, Individual *B* gives $25, even though only a $10 donation is required to receive the album. The first $10 is likely subject to taxation. But it is less clear what happens to the other $15 raised by Taxpayer *A*. Taxpayer *A* would likely argue that though the $10 is taxable, the additional $15 is a gift; therefore, it would not be subject to federal taxation. The reason it is a gift is because the additional $15 was not a quid pro quo but, rather, was given out of affection or charitable impulses.

The IRS, on the other hand, would likely argue that the entire transaction is a business transaction. It does not matter that the "stated price" of the album was $10; since someone paid $25, the entire amount should be included as taxable income. Additionally, the IRS could argue that, similar to a tip for a waiter,[77] Individual *B* was simply tipping Taxpayer *A*. It is likely that the entire amount would be considered taxable; however, sympathetic facts may change this outcome.[78]

75. It is likely that the full $10 would not be fully included in taxable income because only the amount realized would need to be included in gross income. For example, if the album costs $2 to make, the taxpayer would only include $8 in income.

76. *See supra* Section II.A.

77. *See* I.R.C. § 6053(a) (Supp. 2017) (stating that tips are subject to federal taxation).

78. Though it is unlikely that a judge would explicitly state that sympathetic facts led to a certain outcome, it is likely that sympathetic facts may have at least some impact on the outcome of the case. *See* JOAN M. ROCKLIN ET AL., AN ADVOCATE PERSUADES 257 (2016) (stating that using emotional facts can allow the judge to connect with a client). For example, using the hypothetical above, Individual *B* was Taxpayer *A*'s father and he gave him $10,000. It is more likely that the extra $9990 would be considered a gift than a tip. Also, the familial relationship between the parties would help create more sympathetic facts for the taxpayer. *See* BURKE & FRIEL, *supra* note 49, at 52 ("Identifying excludable gifts is generally not a problem when transfers are between family members or close friends.").

Another slight adjustment of the facts raises yet another issue. Instead of Individual *B* giving $25, he gives only $3, receiving no album in return. Since Individual *B* is receiving nothing in return, this donation would likely be considered a gift and not subject to taxation.[79] This is because there is no quid pro quo in that *B* is not receiving anything of value from *A*. Therefore, Taxpayer *A*, in this fact scenario, would likely not have to include the $3 as income.

In rewards-based crowdfunding, the money received will likely be taxed as income, except in situations like the third example. Thus it is presumed that the subsequent expensing of that money would be deductible, assuming the expenses were incurred for a deductible purpose. The remaining analysis in this Recent Development will focus solely on donations-based crowdfunding.

2. Donations-Based Crowdfunding[80]

When a taxpayer raises money through a donations-based crowdfunding platform, as a general rule, the money raised should *not* be subject to federal taxation. Under § 61, any money received through crowdfunding is included as gross income unless another provision excludes it. Section 102(a) would likely exclude money raised through donations-based crowdfunding. Applying the holding in *Duberstein*, when someone contributes money to a donations-based crowdfunding platform, they are doing so out of detached and disinterested generosity. Individuals are contributing money not for a reward or a quid pro quo but rather to express gratitude or because they feel sympathetic for the project creator or beneficiary.[81] This falls directly in line with the "gift" standard set out in *Duberstein*.

It is fair to view crowdfunding as something other than an ordinary gift. In most people's mind, a "gift" is associated with Grandma giving Grandchild $10 for her birthday, not asking for millions of dollars from anyone with an internet connection. The idea that money raised through online solcitations could be a "gift" may seem ridiculous to some.[82] Though crowdfunding may seem different from an "ordinary gift" to many, the Code makes no such distinction.

79. *See infra* Section II.B.2.

80. There are many ways that an individual could set up a donations-based crowdfunding page. For this Recent Development, I am assuming that an individual set up the crowdfunding page personally and has the money coming directly to him. The individual is not operating the crowdfunding page through a charitable organization.

81. *See supra* text accompanying notes 24–28, 59–61.

82. For example, why should a busboy who wants to save money to buy a car be subject to federal taxation on the money earned, while another individual who simply sets up a donations-based crowdfunding page to raise money for a new car is not subject to the

Even if donations-based crowdfunding is viewed as panhandling, the limited authority on the issue still indicates that this money would not be subject to taxation. Several Tax Court decisions show that the money received from panhandling is from detached generosity.[83] As long as the individual contributing money to a donations-based crowdfunding platform is not receiving anything of value, the money received should be considered a gift; therefore, it should not be included in gross income.

Since money raised through donations-based crowdfunding is likely not subject to federal income taxation, those organizing crowdfunding pages should be happy. The taxpayer would not have to include this additional cash flow as taxable income. Now could this taxpayer, despite not including this revenue as income, lower his tax liability even further by taking deductions?

III. SHOW ME THE DEDUCTIONS!

Part II of this Recent Development indicated that taxpayers who receive money through donations-based crowdfunding likely will not have to include amounts raised in their taxable income. This will cause their tax liability to remain stagnant despite the increase in cash flow. Though this is a great first step for crowdfunding taxpayers, another opportunity exists for taxpayers when completing their tax planning. Could the money raised through crowdfunding for a charitable cause subsequently be donated to a charity, allowing the taxpayer to not only exclude the money raised through donations-based crowdfunding from income but also take a charitable deduction on his tax return for the amount donated?[84] Is the answer to this question the same if a taxpayer raised money for medical expenses and subsequently took a medical deduction or raised money to start a new business and subsequently took a business deduction? The final part of this Recent Development attempts to answer these questions. Unfortunately, the answer here is less clear than in Part II. Once again, the longstanding principles of taxation will govern whether these transactions allow a taxpayer who organizes a crowdfunding platform to subsequently take a tax deduction.

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same taxation? Presumably the busboy's wages would be classified as earned income subject to federal taxation, while the donations would be classified as a gift not subject to federal taxation.

83. *See supra* notes 66–69 and accompanying text.

84. The deductible amount of a charitable contribution is still subject to the 50% limitation. *See* I.R.C. § 170(b)(1)(B)(ii) (West 2019) (stating that, generally, an individual's deductions are limited to 50% of their contribution base).

A. Legal Authority

Expenditures are not deductible unless the Code specifically allows.[85] Though the Code allows many tax deductions, only three relate to typical crowdfunding purposes: medical expenses,[86] charitable contributions,[87] and business expenses.[88] These three expenditures can be used to lower a taxpayer's tax liability.[89] Below are the general Code provisions that allow for the deduction of these contributions and expenses.

First, the Code "provides a deduction for uncompensated medical expenses."[90] "There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care . . . to the extent that such expenses exceed 10 percent of adjusted gross income."[91] The deduction for medical expenses is limited to unreimbursed medical expenses.[92] No Code provision prevents money received as a gift from being deducted as a medical expense.[93]

Next, the Code allows a deduction for certain charitable contributions.[94] The Code states, "There shall be allowed as a deduction any charitable contribution . . . payment of which is made

85. This is the opposite of the inclusion of income: everything is included unless specifically exempt. *See supra* text accompanying notes 41–44.

86. I.R.C. § 213 (Supp. 2017) ("There shall be allowed as a deduction the expenses paid . . . for medical care of the taxpayer . . . .").

87. *Id.* § 170(a)(1) (West 2019) ("There shall be allowed as a deduction any charitable contribution . . . .").

88. *Id.* § 162(a) (Supp. 2017) ("There shall be allowed as a deduction all the ordinary and necessary expenses . . . in carrying on any trade or business . . . .").

89. Medical expenses and charitable contributions, however, will only lower a taxpayer's liability if they take an itemized deduction as opposed to a standard deduction. Deductions allow taxpayers to lower their tax liability. *See* SALLY M. JONES & SHELLEY C. RHOADES-CATANACH, PRINCIPLES OF TAXATION FOR BUSINESS AND INVESTMENT PLANNING 412 (2015) (stating that deductions lower adjusted gross income). When filing taxes, an individual taxpayer can take the greater of the standard deduction or itemized deduction. *Id.* The standard deduction is an amount that is determined by the Code based on a taxpayer's filing status. *Id.* at 413. Itemized deductions, on the other hand, "include any deduction allowed to an individual." *Id.* at 415. "Itemized deductions create a tax savings only if the individual elects to itemize. In a year in which the individual claims the standard deduction, any itemized deductions yield no tax benefit." *Id.*

90. BURKE & FRIEL, *supra* note 49, at 372.

91. I.R.C. § 213(a) (Supp. 2017).

92. *See id.* (stating that the deduction is limited to the amount that has not been reimbursed from "insurance or otherwise").

93. The Code, however, does contain several limitations on what medical expenses are deductible and restricts the persons to whom deductions may apply. *See id.* § 213.

94. *See id.* § 170 (West 2019).

within the taxable year."[95] A charitable contribution, at its core, is simply a gift from an individual or company to a charitable organization.[96] A charitable deduction is only allowed when money is contributed to certain types of organizations listed in § 170(c) of the Code.[97] Additionally, if a contribution is not made directly to a charitable organization, but rather to an agent of that charitable organization, a charitable deduction is allowed.[98] A person is only an agent of a charitable organization if the relationship between the person and the charitable organization "clearly purports" to establish an agency relationship pursuant to state law.[99] No Code provisions or Treasury Regulations limit the deductibility of a charitable contribution if the donor first received that money as a gift.

Lastly, the Code allows for the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."[100] Again, there is no limitation in the Code or Treasury Regulations that would prevent the deduction of a business expense because the money was a gift to the business.

B. The Taxpayer's Argument for Deducting Money Raised Through Donations-Based Crowdfunding

As discussed above, the Code provisions addressing charitable contributions, medical expenses, and business expenses do not limit a cash deduction even if the cash was originally received as a gift. Presumably, this lack of limitation indicates that even if money is raised through a donations-based crowdfunding platform, the taxpayer should still be able to take a qualifying deduction.

This analysis makes logical sense for medical deductions, charitable deductions, and business expenses. Suppose Individual *A* gives $100 to Individual *B*. Individual *B* then spends that money on qualifying medical expenses. Nothing in the Code specifically limits money received as a gift from being deductible if it is later spent on medical expenses. Individual *B* should get a $100 medical expense deduction.[101]

95. *Id.* § 170(a)(1).
96. BRUCE R. HOPKINS, THE TAX LAW OF CHARITABLE GIVING 119 (5th ed. 2014).
97. *See* I.R.C. § 170(c) (West 2019) (describing a "charitable contribution" as a contribution to the state or certain organizations).
98. *See* HOPKINS, *supra* note 96, at 496 (citing I.R.S. Priv. Ltr. Rul. 2002-30-005 (Apr. 11, 2002), 2002 WL 1730094).
99. *Id.* at 496–97.
100. I.R.C. § 162(a) (Supp. 2017).
101. This is limited to the extent that such expenses exceed 10% of adjusted gross income and only if the taxpayer itemizes. *See id.* § 213(a).

This analysis should be the same for a charitable deduction or a business expense. Why does this matter? This analysis shows that taxpayers who raise money through donations-based crowdfunding are not only not subject to federal taxation on the money raised but also could subsequently lower their tax liability with deductions.

For example, suppose Taxpayer *A* determines he is going to owe a lot of taxes this year. One way of lowering his taxable income is to increase his deductions. He decides to increase his charitable contributions. Taxpayer *A* does not want to give any of his own money to charity but still wants the deduction. Taxpayer *A* then sets up a GoFundMe page with a goal of raising $10,000 to help benefit the greater Chapel Hill area. Hundreds of people donate to Taxpayer *A*'s GoFundMe page and $10,000 is raised. Taxpayer *A* is not subject to federal taxation on this revenue raised.[102] Taxpayer *A* then donates that money to local charities and takes a charitable deduction for $10,000. If Taxpayer *A* is in the highest tax bracket, this deduction could save the taxpayer $3700.[103] This does not include the additional $3700 that is saved by not having to include this money as taxable income.[104]

As one of my former tax professors said, "If this does not seem important, add zeros to the end of it." The extra zeros will likely put the situation into perspective. For example, as previously noted, J.J. Watt raised over $37 million through crowdfunding.[105] Presumably that money is not taxable to him because it was given to him with donative intent and the charitable purpose of helping the victims of Hurricane Harvey.[106] However, if Watt subsequently donated all of that money to charity, assuming he is in the highest tax bracket, this transaction would have resulted in a tax savings of nearly $13.7 million.[107] Watt could therefore potentially reduce his tax bill, by more than $13 million, by donating money that he solicited for the

102. *See supra* Section II.B.2.

103. This is calculated by multiplying the top income tax rate for 2018, 37%, by $10,000. *See* Rev. Proc. 2018-18, 2018-10 I.R.B. 393–94, 2018 WL 1157105.

104. *37% x $10,000 = $3700*.

105. For purposes of this example, I am assuming that J.J. Watt set up a crowdfunding page personally rather than through a 501(c)(3) organization. This may not be the case, but it provides an example of how important the tax implications could be if a taxpayer chooses to increase his charitable deductions in this manner.

106. *See supra* Section II.B.2.

107. Again, this is calculated by multiplying the top income tax rate for 2018, 37%, by $37,000,000. *See* Rev. Proc. 2018-18, 2018-10 I.R.B. 393–94, 2018 WL 1157105.

purpose of donating in the first place.[108] The analysis would be similar if the deduction was for a medical bill or a business expense, so long as the donor's intent remains one of detached and genuine generosity.

C. The Likely IRS Argument

The IRS will likely challenge these deductions if they begin to affect revenue significantly. The IRS would likely challenge these subsequent deductions on two separate but related grounds: (1) agency principles and (2) the step transaction doctrine.

1. Agency Principles

The IRS would likely argue that a taxpayer attempting to take these deductions should not be allowed to do so because he is simply a "strawman" spending other people's money, rather than his own.[109]

To illustrate this argument, imagine that a taxpayer raised money through donative crowdfunding. The stated purpose of the crowdfunding was to "improve Chapel Hill." People gave this taxpayer $10,000 for this stated purpose. The taxpayer then donated that $10,000 to local nonprofits that did, in fact, improve Chapel Hill. The IRS would argue that this money was not really the taxpayer's but rather was that of the individuals who gave the taxpayer money. The transaction should be treated as if the individuals that gave the taxpayer money just gave the money directly to the charitable organization.

This argument relies on the principles of agency. An agency relationship is created when "one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[110] The IRS would argue that the promoter of the crowdfunding source is simply an agent of the people donating money through crowdfunding. Therefore, the principal, not the agent, should be allowed to take the charitable deduction. For example, Taxpayer *A* gives $100 to

108. Since J.J. Watt is a private citizen, there is no public record of his tax returns. Therefore, there is no way to know how this transaction was actually treated on his individual tax return.

109. An agent would not be allowed to take the deduction because this was not the initial agent's money. The initial agent did not make a payment to a charitable organization with her money; therefore, she is not able to deduct the charitable contribution from her tax liability. *See generally* RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2005) (explaining that an agent acts solely on behalf of its principal).

110. *Id.*

Taxpayer *B*, who then donates it to Charity *C*. Under this agency argument, Taxpayer *A*, not *B*, should receive a charitable deduction. Taxpayer *B*, however, would still not include the $100 as income.

The validity of this argument will depend on whether an agency relationship exists. In other words, it will depend on whether those individuals giving to the crowdfunding page (i.e., principals) have control over the taxpayer organizing the crowdfunding page (i.e., agent). This analysis could turn into a fact-specific analysis, analyzing what exactly the crowdfunding page advertises. For example, control is more likely to be found if a crowdfunding page specifically states that money raised will be donated "directly to Red Cross." This indicates the initial donor has more control since this money can only be donated to the Red Cross. If the crowdfunding page, however, only advertises that this money will "benefit the greater Chapel Hill area," then there is less control because it could be spent on charities, local businesses, schools, or local events.

The IRS will likely argue that even in the latter example, there is still control. This money is still restricted in some way; therefore, an agency relationship exists. Whether this is actually an agency relationship is debatable. For now, however, it is important to note that this is a viable argument.

If crowdfunding pages were found to create an agency relationship, this would have a severe impact on the ability of taxpayers to deduct money raised through crowdfunding. If there is an agency relationship, the IRS would look through this transaction to the original donor to determine whether a tax deduction is allowed. This analysis would depend on the type of deduction that is taken.

For a charitable contribution, the IRS would treat the transaction as if the original donor gave directly to the charity. There would likely be no benefit for this "deduction" if the taxpayer takes the standard deduction.[111] Also, this deduction could be less valuable depending on the taxpayer's tax bracket.[112] For medical expense deductions, the IRS would treat the transaction as if the original donor had paid for those medical expenses. If those medical expenses were not for the original donor, the original donor's spouse, or the original donor's dependent, the medical expense deduction would not be allowed.[113] Lastly, for business deductions, the IRS would treat the transaction as if the

111. This is assuming that the donation is less than the standard deduction. A taxpayer should take the greater of the standard deduction or itemized deduction.

112. *See infra* Section III.E.

113. I.R.C. § 213(a) (Supp. 2017).

original donor had paid for those expenses. If that donor is not the owner of that business, those deductions would not be allowed.[114] A finding of an agency relationship would therefore be detrimental to a taxpayer attempting to take any deduction with money raised through crowdfunding.

There are, however, several issues with finding an agency relationship between a crowdfunding taxpayer and the fund's donors. First, no direct authority states that this type of transaction should be collapsed because a taxpayer takes advantage of a favorable provision in the Code. Tax law does not normally turn on agency principles. Second, this argument could potentially be applied to all money received via gifts through noncrowdfunding sources such as gifts from family and friends. By following this approach, the IRS would essentially attempt to implement a policy that money raised via a gift creates an agency relationship and the receiver could never take a tax deduction when subsequently spending that money. The IRS would likely counter by arguing that this does not apply to all gifts but only to gifts that are restricted for a certain purpose. Lastly, if the IRS relied on an agency relationship argument, it would be conceding that this money should not be included as income for the initial donee. This is because the IRS would be arguing that the initial donee did not have ownership of the money in the first place; therefore, the initial donee did not receive anything of value,[115] and it would not be included as income under § 61 of the Code.

2. The Step Transaction Doctrine

Another possible IRS defense is the step transaction doctrine. "The step transaction doctrine is a variation on the substance over form doctrine . . . ."[116] The substance over form doctrine states that as a general rule, "the incident of taxation depends on the substance rather than form of the transaction."[117] The step transaction doctrine,

114. *See id.* § 162(a).
115. *See id.* § 61.
116. 11 MERTENS, LAW OF FEDERAL INCOME TAXATION § 43:180 (2016).
117. Kuper v. Comm'r, 533 F.2d 152, 155 (5th Cir. 1976); *see also* Comm'r v. Court Holding Co., 324 U.S. 331, 334 (1945). The substance over form doctrine sweeps more broadly than the step transaction doctrine. For example, the substance over form doctrine can change the "form" of a transaction from a sale on credit to a gift. Ray A. Knight & Lee G. Knight, *Substance over Form: The Cornerstone of Our Tax System or a Lethal Weapon in the IRS's Arsenal?*, 8 AKRON TAX J. 91, 97–98 (1991) (stating that if a parent were to "sell" property to their child on credit, the IRS, using the substance over form doctrine, can reclassify the "form" of the transaction to a gift "because neither the parents nor the children have taken seriously the purported obligation to pay the agreed price").

which is closely related, is "designed to ensure that transactions are taxed according to their substance regardless of their form."[118] The step transaction doctrine takes several steps of a transaction and collapses them together, viewing the transaction as a simple, single-step transaction.[119] The step transaction is perhaps best explained through example. If *A* sells a share of stock to *B*, who then sells that stock to *C*, who then sells it to *D*, the step transaction would analyze this series of transactions as if *A* simply had sold the stock to *D*.[120]

What makes the step transaction doctrine difficult to rely on is that "there is no simple guideline for determining when the step transaction doctrine should be applied."[121] In *Gregory v. Helvering*,[122] the Court stated that the step transaction doctrine applied because "the transaction upon its face [lay] outside the plain intent of the statute."[123] This doctrine, however, does not require a taxpayer to structure a transaction to cause a larger tax liability simply because it has fewer steps. "[W]here there are two or more straight paths to the same end result, the taxpayer is not required to take the most expensive route."[124] In other words, if there was a good reason for taking a longer route, the step transaction doctrine would likely not apply.[125]

Here, the IRS would likely attempt to use the step transaction doctrine to eliminate the possibility of deductions for the taxpayer who raised money through crowdfunding. The IRS would argue that the "middle" taxpayer is not necessary to the transaction and therefore should be ignored. A second argument the IRS would likely make is that allowing the "middle" taxpayer to take a deduction would be a transaction that, upon its face, lies outside of the plain intent of the statute.

On the other hand, the taxpayer attempting to take the deduction would likely argue that he is an important and necessary part of the transaction. He is raising these funds and bringing attention to a certain issue. For example, after Hurricane Harvey, it is likely that people would have donated to help hurricane victims, but J.J. Watt unquestionably encouraged donations and increased the

118. MERTENS, *supra* note 116, § 43:180.
119. *See id.*
120. *See id.*
121. *Id.*
122. 293 U.S. 465 (1935).
123. *Id.* at 470.
124. 1 BORIS I. BITTKER ET AL., FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 12.61[3] (7th ed. 2014).
125. *See* Rev. Rul. 83-142, 1983-2 C.B. 68, 1983 WL 190167.

donations that were given.[126] This middle step of crowdfunding was necessary to raise such a large amount of funds for relief.[127]

This same argument would likely translate to a medical deduction or business deduction. For example, Taxpayer *B* has several medical bills related to cancer and sets up a crowdfunding page to help raise money. Taxpayer *A* sees this crowdfunding page and wants to help, so he donates money. Taxpayer *B* will argue that but for her setting up a crowdfunding page, Taxpayer *A* would never have given her any money. This argument should apply to all types of crowdfunding pages. Though the original "donor" could have given directly to a charity, or directly paid a medical bill, the taxpayer will argue that the crowdfunding platform should be viewed as a good reason for the additional steps taken. Therefore, even though there was an additional step taken, the doctrine should not apply.

Unfortunately for the IRS and taxpayers, however, the authority does not point to a clear answer on this issue.

D. How Would a Future Court Rule?

How would a court likely rule in the case of a taxpayer attempting to take this type of deduction? In typical tax form, the answer depends—though it should not. There is no question that this type of transaction, when used in a certain way, seems suspicious. If a taxpayer is using crowdfunding to artificially raise his cash flow to then take a tax deduction through a charitable contribution, a court would be more likely to disallow this deduction. If a taxpayer, however, raised $10,000 for his medical bills and took a medical expense deduction, a court would be more likely to allow this deduction. Similarly, if a taxpayer used the money on his own business and took a business expense deduction, once again, a court would more likely allow this deduction.

These outcomes could simply be a result of more favorable facts.[128] On a technical note, however, a court may hold that the step

126. *See* Sarah Barshop, *J.J. Watt Foundation Says $41.6M in Hurricane Harvey Relief Is Largest Crowd-Sourced Fundraiser in History*, ESPN (Aug. 27, 2018), http://www.espn.com/nfl/story/_/id/24491493/jj-watt-foundation-says-416m-hurricane-harvey-relief-largest-crowd-sourced-fundraiser-history [https://perma.cc/B85N-KZSR].

127. Many other charities use celebrities to raise money for donations. For example, *Big Bang Theory* star Kaley Cuoco addressed the nation in a commercial on behalf of the Humane Society encouraging people to donate money to end animal cruelty. *See* Humane Society, *'Ending Animal Cruelty' Featuring Kaley Cuoco*, ISPOT.TV (2015), https://www.ispot.tv/ad/7cuf/humane-society-ending-animal-cruelty-featuring-kaley-cuoco [https://perma.cc/7NPE-YVA6].

128. ROCKLIN ET AL., *supra* note 78, at 257.

transaction doctrine does not apply where a taxpayer sets up a crowdfunding page to benefit themselves—as opposed to benefiting others. Thus, the step transaction doctrine should only apply to transactions where taxpayers are attempting to take a charitable deduction and not to transactions where taxpayers are attempting to take a medical or business expense deduction. This is because there are fewer steps taken in the medical and business expense deduction scenarios for the ultimate beneficiary to benefit from the funds raised through crowdfunding. For example, when a taxpayer is taking a medical or business expense deduction, the taxpayer is expensing the money raised on his own medical bills or his own business expenses, as opposed to passing along that money to a third-party organization.

Even this type of ruling, which distinguishes charitable deductions from medical and business expense deductions, would create complications. First, this distinction does not address the agency argument. Second, this ruling ignores that even in the medical and business expense deduction scenarios, the money raised through crowdfunding is still being distributed to a third party and thus should be treated the same as the charitable deduction scenario. The money in the medical expense deduction scenario, instead of going to a charitable organization, is going to a medical organization. Likewise, the money in a business expense deduction scenario will ultimately flow to a business. Additionally, the money is still being exchanged the same number of times in all three scenarios. Therefore, the step transaction doctrine, if applied in the charitable deduction scenario, should apply to the other two scenarios as well.

Third, this new rule should theoretically apply to all money raised from gifts, not just money raised through crowdfunding. The implication would be that if *A*'s parents gave her a check for the specific purpose of donating to charity, then even if she gave that money to charity, a deduction would still not be allowed. Lastly, this creates an additional administrative burden for the IRS, which would now have to inquire about how money raised through crowdfunding was used.

Ultimately, if a court wanted to deny the charitable deduction while allowing the medical expense deduction or business expense deduction, it likely would deny the charitable deduction using the step transaction doctrine. This could allow medical and business expense deductions to still be utilized. Though this is how a court could rule on the deduction issue, theoretically all of the outcomes should be the same. In all three scenarios the money is going to a third party, whether it is a business, medical organization, or charitable organization. It is the same amount of steps in each fact scenario. Strictly speaking, under the Code, there is no difference between any of these transactions besides the type of deduction attempted. A technical reading of the Code shows that the outcome of all three should be the same.

E. *What Is at Stake for the Federal Government*

Though J.J. Watt was not raising money for Hurricane Harvey victims to obtain a tax break, the potential for abuse is clearly present, especially when taxpayers are attempting to take a charitable deduction. Some may incorrectly argue that there is no potential abuse. This is because the taxpayers donating to a crowdfunding page could always directly donate to a charitable organization, and they would take the deduction anyway. The argument follows that since the original donor would be able to take a deduction, the federal government is not losing any money. Though it is true that the original donor *may* be able to take the deduction, this argument has two major flaws.

First, this argument assumes that both people donating are in the same tax bracket. If a person who donates $10,000 (Taxpayer *A*) is in the lowest tax bracket, which is 10%,[129] and the taxpayer operating the crowdfunding page (Taxpayer *B*) is in the highest tax bracket, which is 37%,[130] the charitable contribution is less valuable if assigned to Taxpayer *A*. Taxpayer *B* would save $3700 on his tax bill.[131] If assigned to Taxpayer *A*, however, the deduction would only be worth $1000.[132] Taxpayer *B*'s deduction is worth $2700 more because he is in a higher tax bracket. This simple example shows how the federal government in this transaction would lose $2700 in revenue if the donation was assigned to Taxpayer *B*, even though both taxpayers are able to take the deduction.

The second reason that this counterargument is flawed is that it assumes that the initial taxpayer is taking an itemized deduction.[133] In

129. *See* Rev. Proc. 2018-18, 2018-10 I.R.B. 393–94, 2018 WL 1157105.

130. *Id.*

131. *37% x $10,000 = $3700.*

132. *10% x $10,000 = $1000.*

133. When filling out their tax returns, taxpayers have the option to take either an itemized deduction or a standard deduction. An itemized deduction allows the taxpayer to deduct items from their taxable income, such as a charitable contribution or mortgage interest. The standard deduction under the Tax Cut and Jobs Act for a single taxpayer is $12,000. *See* I.R.C. § 63(c)(7)(A)(ii) (West 2019). Therefore, a taxpayer would only take an itemized deduction if their deductions totaled over $12,000. If a taxpayer chooses to

2016, it is estimated that only 30.1% of households took an itemized deduction.[134] With the passage of the Tax Cuts and Jobs Act, that number should only go down since the standard deduction increased to $12,000 for a single taxpayer.[135]

To illustrate this point, again assume that a person who donates $10,000 (Taxpayer *A*) did not take an itemized deduction, and the taxpayer operating the crowdfunding page (Taxpayer *B*) is in the top tax bracket, which is 37%, and takes an itemized deduction. In this example, Taxpayer *A* has no tax benefit resulting from the charitable contribution. Taxpayer *B*, however, reduces his tax liability by $3700.[136] This example illustrates how the federal government would lose $3700 of revenue if the donation is assigned to Taxpayer *B*, because Taxpayer *B* takes an itemized deduction.

These two reasons show that the federal government could lose a substantial amount of revenue if taxpayers who use crowdfunding are allowed to take deductions with money raised through crowdfunding. For these reasons, the federal government is invested in determining whether these deductions will be allowed.

CONCLUSION

Crowdfunding is becoming more prevalent in today's world. Though there are several types of crowdfunding, rewards-based and donations-based crowdfunding raise the question of whether this money is subject to federal income taxation. For rewards-based crowdfunding, the money raised is likely subject to taxation, while money raised by donations-based crowdfunding is likely considered a gift not subject to federal taxation.

This then raises another question for donations-based crowdfunding: Is the subsequent contribution or expensing of that money allowed to be deducted, lowering the taxpayers' tax liability? Strictly applying tax law and tax principles, all deductions should be allowed. If a reviewing court, however, feels this deduction would be an abuse of the Code, then there are tools available to deny the deduction. In the end, for money raised through donative

take the standard deduction, any deductions that qualified as an itemized deduction become worthless for tax purposes.

134. Scott Greenberg, *Who Itemizes Deductions?*, TAX FOUND. (Feb. 22, 2016), https://taxfoundation.org/who-itemizes-deductions/ [https://perma.cc/5EDL-8TS5].

135. *See* § 63(c)(7)(A)(ii); *Analysis of the Tax Cuts and Jobs Act*, TAX POL'Y CTR. (Apr. 16, 2018), http://www.taxpolicycenter.org/feature/analysis-tax-cuts-and-jobs-act [https://perma.cc/NFA5-CNW7].

136. *37% x $10,000 = $3700*.

crowdfunding, a taxpayer almost certainly will not have to claim income but may not be allowed to "double dip" and further lower his tax liability with a subsequent deduction.

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