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Crowdfunding has become a popular way of getting a small business off the ground. In fact, the groundswell has been boosted by recent legislative changes. But what are the tax consequences to recipients? Previously, there was no definitive IRS ruling concerning taxation of contributions to a crowdfunding project. Now a new IRS Information Letter tackles the issue, but the results are still fuzzy (IRS Information Letter 2016-0036, 3/30/16).

As implied by its name, crowdfunding is the process of pooling small investments

Start-ups (JOBs) Act of 2012 increased the limit to 2,000 shareholders, among other modifications. Accordingly, in the wake of the JOBs Act, crowdfunding is on the upswing, with online funding portal such as Kickstarter, Fundable and CircleUp continuing to surge.

To determine the tax implications for crowdfunding, the IRS examined general income tax principles in the information letter. Notably, most payments represent taxable income, unless otherwise excluded under a tax code section. Prevailing regulations say that a taxpayer is treated as being in "constructive receipt" of income if it is credited to his or her account, set apart or otherwise made available so the taxpayer can draw upon it if he or she chooses, The regs further provide that income isn't constructively received if the taxpayer's control is subject to substantial limitations or restrictions.

The problem with applying these rules to crowdfunding is that campaigns are handled in a various ways. For example, in exchange for funds, a contributor might be entitled to equity in the company; products, services or a loan repayment; or nominal awards or acknowledgements such as coffee mugs cups with a logo, T-shirts or tickets to an event. In some cases, the contributor simply makes a gift to support an altruistic cause without receiving any benefit. At other times, the funds are required to be returned to the contributor if the venture peters out.

In the new Information Letter, the IRS concluded that money received without an offsetting liability (e.g., a repayment obligation) that is neither a capital contribution to an entity in exchange for a capital interest in the entity nor a gift constitutes income. The facts and circumstances of each situation must be considered to determine if the money received is taxable

Therefore, crowdfunding revenue generally is included in taxable income if it is not:

- A loan that must be repaid;

In summary, the IRS Information Letter lays out some basic guidelines, but hardly establishes a bright-line test for crowdfunding revenue. The letter also encourages invites recipients to request a private letter ruling from the IRS regarding their specific situation.

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