Hamline Law Review

Volume 37 | Issue 2 Article 3

2014

The Tax Code's Crowdfunding Dilemma: The Temptation of Kickstarter Creators to Use the Gift Exclusion Under Section 102(a)

Eric Dietz
dietz057@gmail.com

THE TAX CODE'S CROWDFUNDING DILEMMA: THE TEMPTATION OF KICKSTARTER CREATORS TO USE THE GIFT EXCLUSION UNDER SECTION 102(a)

Eric Dietz[*]

I. INTRODUCTION

By its own declaration, Kickstarter.com ("Kickstarter"), a website that allows users to finance projects through a method called "crowdfunding," is a platform that allows its users to "bring[] creativity to life."[1] In 2012, over two million people funded more than 18 thousand projects on Kickstarter.[2] In the aggregate, $274,391,721 was contributed to projects on the site.[3] This dwarfed the National Endowment of the Arts'

---

* J.D., Hamline University School of Law, 2013. Eric currently works as a law clerk for the United States Bankruptcy Court in the District of Minnesota.

1 KICKSTARTER, http://www.kickstarter.com/ (last visited Dec. 14, 2013). Kickstarter uses a dynamic homepage, so the phrase, "brings creativity to life," may not always be prominently displayed. However, Kickstarter prominently uses the word, "creativity," in nearly all of its promotion materials across the site. *See id*.

2 *The Best of Kickstarter 2012*, KICKSTARTER, http://www.kickstarter.com/year/2012?ref=footer#overall_pledged (last visited Dec. 14, 2013).

3 *The Best of Kickstarter 2012*, KICKSTARTER, http://www.kickstarter.com/year/2012?ref=footer#overall_stats (last visited Dec. 14, 2013) (Kickstarter generally advertises the amount "pledged," which is greater than the actual amount contributed).

appropriated budget of $146,020,992 in the fiscal year 2012.[4] And, considering that over the course of its five-year life the site has facilitated nearly a billion dollars in contributions, there is little reason to believe that Kickstarter's significance will deteriorate in the near future.[5]

However, despite this success, the service offered by Kickstarter is still wanting in many ways. While Kickstarter provides a significant amount of advice to project creators ("creators") on the process of reaching their funding goal, the site is vague as to the tax consequences befalling those creators.

This is problematic for a few reasons. First, there is the risk that creators will fail to report any of the received contributions as income. In this scenario, a creator may be investigated by the Internal Revenue Service, be subjected to monetary penalties, or face other collateral consequences associated with the failure to pay taxes.[6] While most people understand that money received through Kickstarter is taxable income, Kickstarter frames its service in a way that makes it plausible that a creator could potentially believe he or she has no tax liability from received contributions.

Second, creators may be overtaxed on contributions made to their projects. Kickstarter's funding platform uses a donation-reward system where backers, depending on the circumstances, may or may not receive a thing of value for their contributions.[7] Because of this hybrid system, creators receive an amalgam of contributions consisting of both taxable income and non-taxable gifts. If creators report all of their received contributions as income, they are missing the tax benefits of the gift exclusion under § 102 of the Tax Code.[8]

Third, a combination of both the aforementioned scenarios could occur. A creator may believe he or she can accurately determine which contributions are gifts and which are sales. This is risky for the creator because the nature of these contributions is often unclear. The task of correctly characterizing these contributions as a gift or sale is difficult in most situations, and the typical Kickstarter user is not an expert in tax law.

---

4 *National Endowment for the Arts Appropriation History*, NAT'L ENDOWMENT FOR THE ARTS, http://arts.gov/open-government/nea-budget-planning-information/national-endowment-arts-appropriations-history (last visited Dec. 14, 2013).

5 *Kickstarter Stats*, KICKSTARTER, http://www.kickstarter.com/help/stats?ref=footer (last visited Dec. 14, 2013) (showing Kickstarter has received $916 million in pledges and facilitated $786 million in contributions); *Kickstarter Blog*, KICKSTARTER, http://www.kickstarter.com/blog (last visited Dec. 14, 2013) (banner displaying that the site was established in 2009).

6 Joshua D. Blank, *Collateral Compliance*, 162 U. PA. L. REV. (forthcoming 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2032788 (explaining and providing examples of collateral consequences of failing to pay taxes). For example, if a person owes more than $500 in Minnesota state taxes or has not filed a Minnesota state tax return, that person may not operate a concession stand or ride at the Minnesota State Fair. *See* MINN. STAT. § 270C.72 (2012).

7 *See infra* Part II.B.

8 I.R.C. § 102(a) (2012).

Most projects raise less than $10,000, so it is unlikely that contributed money is being used to hire a tax professional.[9] Under these circumstances, a creator may be tempted to employ self-help, possibly to his or her detriment.

This article examines this problem in detail, from the way Kickstarter markets its service to the difficulty in differentiating between gifts and sales in the context of Kickstarter's crowdfunding model. To this end, the article will address the mechanics of crowdfunding and Kickstarter, the current legal state of the law surrounding gifts, and examine the difficulty in determining whether a contribution should be characterized as taxable income or a gift. Finally, the article will attempt to identify what party or parties should be responsible for the resolution of this problem.

II. CROWDFUNDING AND KICKSTARTER

A. Crowdfunding

Crowdfunding is a relatively new method for entrepreneurs to finance projects that otherwise may not be suitable for traditional methods of investment. For example, the recently released film, Veronica Mars was funded via contributions from over 90,000 people in the amount of $5,702,153. [10] Crowdfunding relies on small contributions from many different entities to finance a project, unlike funding methods based on traditional debt or equity models.[11]

While all crowdfunding platforms share the common trait of numerous backers and small contributions, certain platforms differ in the method by which creators solicit potential backers. For example, EarlyShares is a crowdfunding site that allows project creators to offer equity in the company carrying out the project.[12] Giveforward is a site where creators offer no tangible reward, but rather reach out to the charitable nature of the

---

[9] Michael McGregor & Fred Benenson, *Five Million Backers!*, KICKSTARTER (Oct. 29, 2013), http://www.kickstarter.com/blog/five-million-backers.

[10] Rob Thomas, *The Veronica Mars Movie Project*, KICKSTARTER, https://www.kickstarter.com/projects/559914737/the-veronica-mars-movie-project?ref=live (last visited Mar. 16, 2014).

[11] *See* Tanya Prive, *What Is Crowdfunding and How Does It Benefit the Economy*, FORBES (Nov. 27, 2012), www.forbes.com/sites/tanyaprive/2012/11/27/what-is-crowdfunding-and-how-does-it-benefit-the-economy/.

[12] *What is Crowdfunding?*, EARLYSHARES, http://www.earlyshares.com/learn-more/university/what-is-crowdfunding (last visited Jan. 6, 2014). In 2012, Congress adopted the JOBS Act, which permits small companies to use the Internet to offer investment options. Sara Hanks & Andrew Stephenson, *Online Securities Offerings*, BANKING & FIN. SERVICES POL'Y REP., Feb. 2014, at 1. Pursuant to the JOBS Act, the Securities and Exchange Commission has adopted regulations that permit offerings to "accredited" investors. *Id*.

backer.[13] Kickstarter allows its creators to offer small "rewards" in exchange for contributions.[14]

Prior to the rise of crowdfunding, smaller projects were often left with relatively few financing options.[15] A small project may not be worth a traditional lender or investor's time in comparison with larger opportunities.[16] Moreover, a new or creative project may be too risky for a traditional lender or investor.[17] These small, creative projects benefit the most from crowdfunding's reliance on many contributions from many different entities.[18] Under this model, risk is reduced to the creator and the backers, making the financing of the project more likely.[19]

B. Kickstarter Specifics: The Process and the Problem

Crowdfunding, while the core of Kickstarter's business model, is the key aspect of its users' tax dilemma of separating transactions into gifts or sales. The way crowdfunding is implemented on Kickstarter's site makes this particularly difficult because creators can solicit contributions by providing things of value, acts of gratitude, or a combination of the two.[20] Moreover, Kickstarter's internal rules and advice have further obfuscated the nature of transactions on the site.[21] As a result, creators have a difficult task in determining if a contribution qualifies as a gift under § 102 of the Tax Code.

1. Kickstarter Creators

To understand the nature of the problem for Kickstarter creators, it is important to understand the roles of the different actors involved in the overall process, beginning with the creators themselves. Though the creator is where the project originates, the creator must conform the project to two main guidelines.[22] First, the project must have a "clear end."[23] Second, the

---

[13] *How It Works*, GIVEFORWARD, http://www.giveforward.com/learn#howitworks (last visited Jan. 6, 2014).

[14] *Creating Rewards*, KICKSTARTER, http://www.kickstarter.com/help/school #creating_rewards (last visited Jan. 6, 2014).

[15] Tanya Prive, *Top 10 Benefits of Crowdfunding*, FORBES (Oct. 12, 2012), www.forbes.com/sites/tanyaprive/2012/10/12/top-10-benefits-of-crowdfunding-2/. Funding from family and friends may be available for these types of projects, but that has its limits and is not a source that is equally available to all entrepreneurs. *See* DWIGHT DRAKE, BUSINESS PLANNING 181–82 (4th ed. 2013).

[16] DRAKE, *supra* note 15.

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *See infra* Part II.B.3.

[21] *See infra* Part II.B.3.

[22] *Guidelines*, KICKSTARTER, http://www.kickstarter.com/help/guidelines (last visited Jan. 9, 2014).

project must fit into one of the proscribed categories, such as comics, games, or music.[24] In addition to these two requirements, Kickstarter also prohibits certain types of activities, such as offering equity as a reward, soliciting loans, or creating projects that offer drugs or alcohol as a reward.[25] Beyond this, creators have near complete control over the direction of their project.

Along with the details of the project, the creator must also set a funding goal and a length of time in which that goal must be reached.[26] Kickstarter operates on an all-or-nothing funding model.[27] This means that if the goal set by the creator is not met, no money changes hands.[28] The creator either receives pledges equal to or exceeding the funding goal, or she receives no contributions at all.[29]

Finally, the creator must establish a tiered reward system for backers.[30] Under Kickstarter's donation-reward model, creators must provide rewards for different levels of contributions, e.g., a reward at five dollars; at twenty dollars; and so on. The level of contribution set for a reward is the minimum that must be contributed; thus, if a reward is set a contribution level of $100, a person contributing $100 is free to choose that reward or any reward set below $100.[31]

Rewards can be as simple as a thank-you card or as complex as a hot-air balloon ride. However, Kickstarter recommends that the creator offer things made by the project itself.[32] For instance, a creator developing a video game may offer the game itself as a reward to backers.[33]

Kickstarter advocates that rewards should be "fairly priced" and "reasonably close to its real-world cost."[34] However, the site contemplates the idea that a "one-of-a-kind experience" will give the creator flexibility in

---

23 *Id.* (stating that "[a] project will eventually be completed, and something will be produced as a result").

24 *Id.* The full list includes: art, comics, dance, design, fashion, film, food, games, music, photography, publishing, technology, and theater. *Id.*

25 *Id.*

26 *Kickstarter School*, KICKSTARTER, http://www.kickstarter.com/help/school #setting_your_goal (last visited Jan. 9, 2014). The funding period is limited to a maximum duration of sixty days. *Id.*

27 *FAQ*, KICKSTARTER, http://www.kickstarter.com/help/faq/kickstarter+basics (last visited Jan. 9, 2014).

28 *Id.* Kickstarter believes that the all-or-nothing funding model has clear benefits. Because a creator will not be in a position to perform a $5,000 project if he or she has only raised $1,000, Kickstarter requires the creator to fully fund his or her project. Moreover, this model forces creators to be active in promoting the project and ensures that only projects with significant support go forward. *Id.*

29 *Id.*

30 *See Kickstarter School*, *supra* note 26.

31 *See FAQ*, *supra* note 27.

32 *Kickstarter School*, *supra* note 26.

33 *See* Double Fine & 2 Player Productions, *Double Fine Adventure*, KICKSTARTER, http://www.kickstarter.com/projects/doublefine/double-fine-adventure (last visited Jan. 10, 2014) (offering the game if a backer pledges $15 or more).

34 *Kickstarter School*, *supra* note 26.

pricing.[35] Kickstarter also recommends "[c]reative mementos" as possible rewards, such as photos from the project and thank-you messages.[36] In practice, most projects utilize rewards that would be considered items of actual value and items of nominal value.[37]

Once the project, funding goal, and rewards are chosen, the project will be posted on Kickstarter's site.[38] From that point, potential backers are free to pledge money to the project. Their support will determine whether the project succeeds or fails.

2. Kickstarter Backers

While creators are the foundation of projects, backers are the avenues of support for those projects.[39] The creators' actions, from the project description to the offered rewards, are meant to entice and motivate backers to pledge money to the project.[40] These pledges are what determine whether a project will be funded or denied under Kickstarter's all-or-nothing funding model.[41]

Backers pledge money to a creator's projects on Kickstarter.[42] Once the project is created, backers can access a project page that shows a description of the project, the rewards available to backers, and the amount of money pledged.[43]

When a backer makes a pledge, the transaction does not immediately take place.[44] Rather, backers make pledges during the duration of the funding period, and if the funding goal is met during that period, funds are transferred from the backers to the creator.[45] This means that if a project fails to meet its funding goal, no money is exchanged.[46]

---

[35] *Id.*

[36] *Id.*

[37] *See, e.g.*, Enormous Industries, *Duo Coffee Steeper*, KICKSTARTER, http://www.kickstarter.com/projects/1347010534/duo-coffee-steeper (last visited Jan. 10, 2014) (offering a "big thank you" for a $1 pledge and the product itself for a $55 pledge).

[38] *FAQ*, *supra* note 27.

[39] *Start a Project*, KICKSTARTER, http://www.kickstarter.com/start (last visited Jan. 10, 2014) (referring to support for projects coming from people the creator knows and from visitors to the Kickstarter site).

[40] *See Kickstarter School*, *supra* note 26 (stating that "[b]ackers can judge how realistic the project's goals are," and that "[r]ewards are what backers receive in exchange for pledging to a project").

[41] *Id.*

[42] *FAQ*, *supra* note 27.

[43] *See* Pebble Technology, *Pebble: E-Paper Watch for iPhone and Android*, KICKSTARTER, http://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android (last visited Jan. 11, 2014) (containing the project description, money pledged, and rewards, along with other information).

[44] *See FAQ*, *supra* note 27 (stating "[i]f the project succeeds in reaching its funding goal, all backers' credit cards are charged when time expires").

[45] *Id.*

[46] *Id.*

When a backer pledges an amount of money to a project, she also chooses a reward based on her contribution level.[47] During the funding period, backers have the ability to contact creators, interact with other contributors in a forum for the project, and change their contribution level.[48] If the project is successfully funded, the expectation is that the creator will fulfill the promised rewards.[49]

3. Transactions

The transaction between the creator and backers on Kickstarter is unique because in the context of Kickstarter's site, the legal nature of the transaction is unclear. Kickstarter, in most of its promulgated materials, seems to go out of its way to avoid equating this transaction to a sale of goods or services in the traditional sense.[50] However, when one examines the actual process, the transactions taking place on Kickstarter are similar, if not identical, to those of online retailers in many circumstances. These dissonant signals lead to confusion in determining the nature of transactions on Kickstarter.

Kickstarter advertises itself as "a funding platform for creative projects."[51] Kickstarter does not refer to itself as an online store or retailer. Creators on Kickstarter offer rewards; they do not sell products.[52] The site describes this model as a "mix of commerce and patronage," but does not explicitly state that creators can raise money by selling products.[53]

While Kickstarter leans away from the notion that creators are selling products, certain aspects of the site's advertising allude that this may be the case. For instance, Kickstarter suggests that rewards should be "tangible" and "fairly priced."[54] Moreover, Kickstarter recommends that "[e]very project's primary rewards should be things made by the project itself."[55] It also advises creators to offer items of "actual value" and states "if it's a manufactured good, then it's a good idea to stay reasonably close to its real-world cost."[56] Again, there is no explicit statement that creators are selling products on Kickstarter. However, these recommendations seem to infer that the incentives for backers are similar to the incentives that would entice buyers to purchase products from a traditional retailer.

---

47 *Id.*

48 *FAQ, Backer Questions: Backing a Project,* KICKSTARTER, https://www.kickstarter.com/help/faq/backer+questions?ref=faq_nav#BackAProj (last visited Apr. 1, 2014).

49 *FAQ*, *supra* note 27.

50 *See infra* text accompanying notes 58–59.

51 *Id.*

52 *Kickstarter School*, *supra* note 26.

53 *Id.*

54 *Id.*

55 *Id.*

56 *Id.*

The true nature of the transactions is further obfuscated by Kickstarter's Terms of Use. On one hand, Kickstarter explicitly states that, "[b]y creating a fundraising campaign on Kickstarter, you as the Project Creator are offering the public the opportunity to enter into a contract with you. By backing a fundraising campaign on Kickstarter, you as the Backer accept that offer and the contract between Backer and Project Creator is formed."[57] Moreover, "Project Creators are required to fulfill all rewards of their successful fundraising campaigns or refund any Backer whose reward they do not or cannot fulfill."[58] This statement infers that the transaction between creators and backers is a formal one, similar to the relationship between traditional buyers and sellers.

On the other hand, Kickstarter softens this position by including in its Terms of Use: "[t]he Estimated Delivery Date listed on each reward is not a promise to fulfill by that date, but is merely an estimate of when the Project Creator hopes to fulfill by;" "Project Creators agree to make a good faith attempt to fulfill each reward by its Estimated Delivery Date;" and "Project Creators may cancel or refund a Backer's pledge at any time and for any reason, and if they do so, are not required to fulfill the reward."[59] Despite the fact that Kickstarter explicitly states that a contract is formed between the creator and backers, the actual rights and duties of the parties are not well defined considering the creator and backers may alter their performance at nearly any time in the course of the transaction.[60] Again, Kickstarter's internal narrative of the transaction between creators and backers is confusing, if not contradictory.

Kickstarter's muddled impression of the transactions on its site may not be problematic if the actual, real-world usage of the site yielded a clear type of transaction. However, because Kickstarter uses a donation-reward system, often transactions take place where backers receive items of value, nominal tokens of gratitude, or a combination of the two.[61]

One example highlighting the "reward" aspect of Kickstarter's donation-reward system is the OUYA video game console.[62] Successfully funded in August 2012 with $8,596,474, backers contributing $95 or more could receive the console itself as a reward.[63] A little less than a year later,

---

57 *Terms of Use*, KICKSTARTER, http://www.kickstarter.com/terms-of-use (last updated Oct. 2012).

58 *Id.*

59 *Id.*

60 *See id.*

61 *See supra* text accompanying notes 36–37.

62 OUYA, *OUYA: A New Kind of Video Game Console*, KICKSTARTER, http://www.kickstarter.com/projects/ouya/ouya-a-new-kind-of-video-game-console (last visited Jan. 12, 2014).

63 *Id.*

the general public could purchase the console for $99, a price point nearly identical to the price paid by backers for the same product.[64]

The process utilized by a backer in obtaining the OUYA console is nearly identical to a patron purchasing it on a traditional online retailer. In choosing the OUYA console as a reward, backers navigated to Kickstarter's site, chose the OUYA console as a reward, and provided payment information.[65] This is very similar in form to a transaction on Amazon.com ("Amazon"), one of the United States' largest online retailers.[66] On Amazon, a customer navigates to Amazon's site, chooses a product, and provides payment information.[67] In essence, the transactions on Kickstarter and Amazon are nearly identical; one party offers a product, and the other party provides a specified amount of money in exchange for that product.

In contrast, a project illustrating the "donation" aspect of Kickstarter's system is the Sansaire Sous Vide Circulator.[68] Successfully funded in September 2012 with $823,003, backers contributing $5 or more could receive "eternal gratitude."[69] Unlike the backers receiving the OUYA console for their pledge, backers pledging $5 to the Sansaire Sous Vide Circulator received nothing tangible. Sansaire has not continued offering "eternal gratitude" after completing its Kickstarter project.[70]

The motivation of the $5 backer of the Sansaire project versus the motivation of the $99 OUYA backer is clearly different. Where the backers of OUYA were incentivized in a fashion similar to a purchaser of goods, the backers of Sansaire were incentivized in a way similar to a person making a donation.

Finally, many projects contain both the "reward" aspects and the "donation" aspects of Kickstarter. For example, the Sill, funded in April 2012, gave backers at the $10 level a themed thank-you note written on seed paper.[71] An album by Kishi Bashi funded through Kickstarter offered a

---

64 Ben Gilbert, *OUYA Available at Retail on June 4 for $99*, ENGADGET (Mar. 28, 2013), http://www.engadget.com/2013/03/28/ouya-at-retail-june-4/.

65 *See FAQ*, *supra* note 27 (discussing the process of a backer selecting rewards and pledging money).

66 *See* Ben Streitfeld, *Amazon's Revenue Soars, But No Profit Is in Sight*, N.Y. TIMES, Oct. 24, 2013, at B3, *available at* http://www.nytimes.com/2013/10/25/technology/amazons-revenue-soars-but-no-profit-in-sight.html (stating that Amazon's revenue in the third quarter of 2013 was $17.09 billion).

67 *See generally* AMAZON, http://www.amazon.com/ (last visited Jan. 12, 2014).

68 Scott Heimendinger, *Sansaire Sous Vide Circulator*, KICKSTARTER, http://www.kickstarter.com/projects/seattlefoodgeek/sansaire-sous-vide-circulator-for-199 (last visited Jan. 15, 2014). The Sansaire Sous Vide is the "only tool you need to cook sous vide." *Id.*

69 *Id.*

70 *See Shop*, SANSAIRE, http://sansaire.com/shop/ (last visited Jan. 15, 2014) (showing an absence of "eternal gratitude").

71 Gwen Blevins, *The Sill—A Plant on Every Sill*, KICKSTARTER, http://www.kickstarter.com/projects/thesill/the-sill-a-plant-on-every-sill (last visited Jan. 13, 2014). The Sill was a project that commissioned artists to make "an eclectic mix of planter styles." *Id.*

twenty to thirty second "song message" as a reward for a pledge of $100.[72] A podcast called "The Comedy Button," offered backers who contributed $1,000 the opportunity to spend the day at an amusement park, water park, or zoo with the cast of the show.[73]

When projects offer these types of rewards, the vague nature of a transaction on Kickstarter is apparent. While seed paper has a value and a person could purchase it, the fact that it is being used for a thank-you note implies that this transaction is not a sale.[74] Similarly, the service being received in the cases of the song message and the trip to the amusement park could theoretically be assigned a value, but the personalized, unique nature of these rewards make them feel different from the typical buyer-seller relationship.

As you can see, Kickstarter transactions, despite often looking like sales involving a buyer and a seller, cannot easily be generalized as such. Kickstarter itself refrains from characterizing in that way, and often the transactions themselves look like something more akin to a donation. Due to these competing aspects of transactions on Kickstarter, the nature of those transactions is difficult to grasp.

III. THE PROBLEM FOR THE CREATOR-TAXPAYER

Creators, as the recipients of contributions from backers, bear the burden of the tax implications resulting from transactions on Kickstarter. As already discussed, the nature of these transactions is often difficult to ascertain.[75] This leads to a number of problems, particularly that creators are tempted to classify transfers as gifts instead of taxable income.

A. The Threshold Issue: Kickstarter Contributions Are Income

The nature of Kickstarter transactions is important because creators are likely receiving taxable income as a result of the contributions received from backers.[76] If a creator wrongfully believes that this is not the case, or incorrectly characterizes a portion of those contributions as gifts, the creator faces the possibility of a deficiency and any collateral consequences

---

72 Kishi Bashi, *Kishi Bashi's Making a Debut Album!!*, KICKSTARTER, http://www.kickstarter.com/projects/kishibashi/kishi-bashis-making-a-debut-album (last visited Jan. 13, 2014).

73 Scott Bromley, *The Comedy Button Podcast*, KICKSTARTER, http://www.kickstarter.com/projects/988149443/the-comedy-button-podcast-from-the-makers-of-the-d (last visited Jan. 13, 2014).

74 *See, e.g.*, *OTE Lotka Printable Seed Paper*, AMAZON, http://www.amazon.com/OTE-Lotka-Printable-Seed-Paper/dp/B0035TU7VA (last visited Jan. 14, 2014).

75 *See supra* Part II.B.3.

76 *See* Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955) (interpreting "income" as an "accession[] to wealth, clearly realized, [] over which the taxpayer ha[s] complete dominion").

associated with the deficiency.[77] Therefore, the ambiguity of these transactions is troubling when considering the possible effects it may have on creators.

Congress has the power to collect taxes on income and has chosen to do so in a broad fashion.[78] In the Internal Revenue Code (the "Code"), Congress has stated, "gross income means all income from whatever source derived."[79] This includes compensation for services and gains derived from dealing in property.[80]

Courts, in interpreting these provisions, have similarly been liberal in their interpretation of what constitutes income. In *Glenshaw Glass*, the United States Supreme Court stated that taxpayers have income when there are instances of "undeniable accessions of wealth, clearly realized, and over which the taxpayers have complete dominion."[81] The Court emphasized that Congress intended to "exert the full measure of its taxing power" under the Sixteenth Amendment when enacting the IRS Code.[82] Further, the Court noted that the enumerated examples in the Code do not limit what can be considered income for purposes of taxation.[83] Given this broad notion of income, a taxpayer-creator will likely have taxable income from at least some contributions received through Kickstarter.

B. The Gift Exclusion

Despite Congress' broad conception of income, it has created an exception in the Code for gifts.[84] Section 102(a) of the Code excludes "the value of any property acquired by gift" from gross income.[85] While gifts often occur between friends and family, exchanges between business partners, an employer and employee, and even complete strangers can be considered gifts as well.[86] However, this does not mean that the relationship between the parties is immaterial. Gifts in the familial context are common and usually qualify for § 102 treatment.[87] In contrast, a "gift" in a commercial or business setting is less likely to receive favorable treatment under § 102.[88] In determining whether a transfer of property is a gift, the

---

77 *See* Blank, *supra* note 6.
78 U.S. CONST. amend. XVI; *Glenshaw Glass*, 348 U.S. at 430.
79 I.R.C. § 61(a) (2012).
80 I.R.C. § 61(a)(1)–(2).
81 *Glenshaw Glass*, 348 U.S. at 431.
82 *Id.* at 429.
83 *Id.* (quoting Helvering v. Clifford, 309 U.S. 331, 334 (1940)).
84 I.R.C. § 102(a) (2012).
85 *Id.*
86 MARTIN BURKE & MICHAEL FRIEL, TAXATION OF INDIVIDUAL INCOME 90 (9th ed. 2010).
87 *See id.* (stating that "the further a transfer is removed from the family context, the more strained the justification for gift exclusion").
88 *See* I.R.C. § 102(c)(1) (generally barring the application of the gift exception in the employer-employee context).

primary factor is whether the transferor intended to make a gift from a "detached and disinterested generosity."[89]

Congress has never provided a definition for the term "gift." However, the Supreme Court defined it in the case *Commissioner v. Duberstein*.[90] In *Duberstein*, the government advocated that the Supreme Court adopt a test where "gifts" would be determined by the context in which they are given.[91] Transfers made for business reasons, such as payments made by an employer to an employee, could not qualify as a gift.[92] In contrast, transfers made for "personal" reasons are more apt for the gift exclusion.[93]

The Court rejected this proposed test, stating, "these propositions are not principles of law but rather maxims of experience that the tribunals which have tried the facts of cases in this area have enunciated in explaining their factual determinations."[94] The Court concluded, "whether a transfer amounts to a 'gift' is one that must be reached on consideration of all the factors."[95]

In defining the term, "gift," the Court stated that "[w]hat controls is the intention with which payment, however voluntary, has been made."[96] The Court elaborated, "the most critical consideration . . . is the transferor's 'intention' of making a gift out of a 'detached and disinterested generosity.'"[97] The Court also said that a gift is a transfer made "out of affection, respect, admiration, charity, or like impulses."[98] Despite being cited in nearly every decision addressing whether a transfer is a gift, this definition has proved difficult to apply.[99]

For instance, and particularly relevant regarding Kickstarter transactions, a question arises as to what degree of "detached and disinterested generosity" is required for the gift exclusion to apply. Moreover, if the transferor received an indirect benefit from the transferee, can a transfer still qualify as a gift? The appellate courts have, at least in part, addressed these questions.

---

89 Comm'r v. Duberstein, 363 U.S. 278, 287 (1960).
90 *Id.* at 285.
91 *Id.* at 287.
92 *Id.*
93 *Id.*
94 *Id.*
95 *Duberstein*, 363 U.S. at 288.
96 *Id.* at 285–86.
97 *Id.* at 285.
98 *Id.*
99 *Compare* Olsen's Estate v. Comm'r, 302 F.2d 671, 674 (8th Cir. 1962) (characterizing a payment by a corporation to a widow of a former employee as a gift because the company had no "moral obligation or duty" to make a payment), *with* Kuntz v. Comm'r, 300 F.2d 849, 851 (6th Cir. 1962) (characterizing a payment to the widow of a former employee as a gift, despite the fact that the payment was referred to as "compensation" in the board's resolution).

In the Eighth Circuit case, *Goodwin v. United States*, a popular pastor, who grew a congregation of 25 to nearly 400, was routinely provided with cash "gifts" from his congregation.[100] These transfers were regularly made on three "special occasion" days each year, and a procedure was followed on each occurrence.[101] Two weeks before the gift was to be made, the associate pastor would announce the gift-giving occasion when the Goodwins were not present. [102] Two weeks later, members of the congregation would give envelopes with cash to the associate pastor or church deacon.[103]

It should be noted that there was neither a written policy nor requirement that anyone give a gift, nor were congregation members counseled or encouraged to give in any amount.[104] Moreover, every member of the congregation that was deposed maintained that the "gifts" were given out of "love, respect, admiration and like impulses and [were] not given out of any sense of obligation or any sense of fear that [Reverend Goodwin] [would] leave their parish if he [was] not compensated beyond his yearly salary."[105]

While the transferor's intent in this case seems to have met the definition established in *Duberstein*, the Eighth Circuit refused to consider these transfers a "gift" for tax purposes.[106] The court noted, "the critical fact in this case is that the special occasion gifts were made by the congregation as a whole, rather than by individual members." Moreover, "the cash payments were gathered . . . in a routinized, highly structured program."[107] The court concluded that "[t]he congregation, collectively, knew that without these substantial, on-going cash payments, the Church likely could not retain the services of a popular and successful minister at the relatively low salary it was paying."[108] Thus, the payments did not fit within the definition of a "gift" for tax purposes.[109]

The Ninth Circuit addressed a similar situation, but in a very different factual context. In *Olk v. United States*, craps dealers received money, called "tokes," from gamblers at casinos.[110] During play, gamblers would often give tokes to dealers or place bets for them.[111] At the end of the shift, the tokes would be split among the dealers.[112] Each would get an equal

100 Goodwin v. United States, 67 F.3d 149, 150 (8th Cir. 1995).
101 *Id.*
102 *Id.*
103 *Id.*
104 *Id.*
105 *Id.*
106 *Goodwin*, 67 F.3d at 152–53.
107 *Id.* at 152.
108 *Id.*
109 *Id.* at 152–53.
110 Olk v. United States, 536 F.2d 876, 876 (9th Cir. 1976).
111 *Id.* at 877.
112 *Id.*

share of the total, regardless of whether the dealer was working when the tokes were received.[113] Casino management did not encourage this practice, as the tokes represented money that was not being bet and therefore could not be won by the casino.[114]

Like in *Goodwin*, no obligation existed on the part of the transferor to give the dealer tokes.[115] There was no direct relationship between the player and the dealer, and "[no] obligation on the part of the patron [existed] to give to a dealer and dealers perform no service for patrons which a patron would normally find compensable."[116] To that point, only about ten percent of players gave any tokes at all.[117] The lower court also found that "tokes are given to dealers as a result of impulsive generosity or superstition on the part of players, and not as a form of compensation for services."[118] Furthermore, it found "[t]okes are the result of a detached and disinterested generosity on the part of a small number of patrons."[119]

Again, under these circumstances, it would seem that the standard in *Duberstein* is satisfied. However, the Ninth Circuit ruled that these transfers did not qualify as "gifts" under the Code. The court recognized, "[t]ribute to the gods of fortune which it is hoped will be returned bounteously soon can only be described as an 'involved and intensely interested' act."[120] The court also stated, "[t]he regularity of the flow, the equal division of the receipts, and the daily amount received indicate that a dealer acting reasonably would come to regard such receipts as a form of compensation for his services."[121]

Olk and *Goodwin* represent a significant split from the standard set out by the Supreme Court. In *Duberstein*, the Supreme Court stated that what controls is the transferor's intent.[122] However, in both *Olk* and *Goodwin*, the circuit courts supported their conclusions by citing the factual circumstances surrounding the transaction, such as the regularity of the payments and the procedure followed in making the payments. Moreover, these two cases make clear that an indirect benefit to the transferor may be sufficient to foreclose gift treatment, even if that indirect benefit does not flow from the

---

113 *Id.* The court noted, "a dealer will get his share of the tokes received even while he is taking his break." *Id.*

114 *Id.*

115 *Olk*, 536 F.2d at 877.

116 *Id.* (internal quotation marks omitted).

117 *Id.*

118 *Id.*

119 *Id.*

120 *Id.* at 879.

121 *Olk*, 536 F.2d at 879. The Ninth Circuit's analysis is logical on this point. A player of a game of chance would of course be "intensely interested" if giving "tokes" changed his or her luck. However, the court in *Olk* has not helped taxpayers determine what is or is not a gift. Is there any situation where a gift-giver is not "interested" in some degree? Parents are generally "intensely interested" in their children, but those transfers will likely qualify for gift treatment.

122 *Duberstein*, 363 U.S. at 285.

transferee.[123] Therefore, in determining whether a transfer is a gift, one must look at both the transferor's intent and the circumstances surrounding the transaction.

C. The Temptation of the Creator-Taxpayer

Determining whether a transaction is a gift is a nearly impossible task for both laypersons and legal professionals alike. The Supreme Court standard, based on the donor's intent, is vague and difficult to apply. In *Duberstein*, Justice Brennan admitted as much, stating, "[t]his conclusion may not satisfy an academic desire for tidiness, symmetry and precision in this area."[124] Furthermore, as illustrated by *Goodwin* and *Olk,* the circuit courts have made this more complicated by relying on factual circumstances surrounding the transaction, yet failing to clarify the exact circumstances that would preclude gift treatment.[125] Determining whether a transaction is a gift is a daunting task and even if a determination is made, it would be surrounded by uncertainty. Unfortunately, taxpayer-creators are not only incentivized to engage in this process, but also prompted to do so by Kickstarter itself.[126]

As stated above, most projects raise less than $10,000, and this money is tightly budgeted.[127] Creators not only need a sufficient amount of funds to carry out the project as intended, but also must budget to fulfill rewards to backers. Moreover, both Kickstarter and Amazon[128] apply fees to the total contributions, further reducing the amount available to the creator.[129] Therefore, creators are very likely looking for ways to stretch the money they receive through Kickstarter in any way possible, including reducing their tax burden. And, given their tight budget, they are likely to classify their own contributions (or do their own taxes) as opposed to seeking

---

123 For example, in *Goodwin*, the court noted that "[t]he congregation, collectively, knew that without these substantial, on-going cash payments, the Church likely could not retain the services of a popular and successful minister at the relatively low salary it was paying." *Goodwin*, 67 F.3d at 152. Similarly, in *Olk*, the court reasoned that tokes from donors, intended to increase their luck, are not the result of detached and disinterested generosity, even if the tokes are given to casino employees. *Olk*, 536 F.2d at 879.

124 *Duberstein*, 363 U.S. at 290.

125 *See supra* Part III.B.

126 *Kickstarter and Taxes*, KICKSTARTER, http://www.kickstarter.com/help/taxes (last visited Jan. 18, 2014).

127 McGregor & Benenson, *supra* note 9. As shown in the pie graph, seventy-five percent of projects raise $9,999 or less. *Id.*

128 Amazon receives a fee because Kickstarter requires its users utilize Amazon Payments, a service for sending and receiving money. *Why Amazon Payments*, AMAZON PAYMENTS, https://payments.amazon.com/business/overview?ld=NSCBAGooglePA (last visited Mar. 16, 2014). Amazon Payments charges a standard transactional rate of 2.9% plus $0.30 per transaction over $10. *Pricing*, AMAZON PAYMENTS, https://payments.amazon.com/business/pricingPlan?ld=NSCBAGooglePA (last visited Mar. 16, 2014).

129 *See FAQ*, *supra* note 27. Kickstarter applies a five percent fee to successfully funded projects and Amazon applies a three to five percent processing fee. *Id.*

professional help, putting themselves at risk of civil or criminal action by the IRS.

As if the monetary temptation to engage in this practice is not enough, Kickstarter itself actually suggests that creators may use the gift exclusion.[130] Kickstarter's "A guide for your accountant" states, "a creator may be able to classify certain funds raised on Kickstarter as a nontaxable gift, and not income. A gift is something given out of 'detached and disinterested generosity' for personal reasons and without the expectation of getting something in return."[131] While Kickstarter does not go so far as to advocate that creators use the gift exclusion, the inclusion of this statement leads to a number of problems.

First, by including this statement, Kickstarter can be seen as encouraging creators to engage in the process of classifying some backer contributions as nontaxable gifts where they otherwise would not have done so. Where attempting this process may not have naturally occurred to a creator, the suggestion that it is a possibility puts the idea in the creator's mind. Moreover, the inclusion of this possibility legitimizes its use in the eyes of the creator. If Kickstarter had not included this statement, the creator might be more apprehensive about utilizing the exclusion.

Second, the definition of a gift is far more complicated than Kickstarter's statement would suggest. Even transfers given out of a "detached and disinterested generosity" may not qualify for gift treatment in certain factual situations. As *Olk* and *Goodwin* suggest, transfers regularly made that follow a specific procedure are grounds for barring the use of the gift exception.[132] Moreover, an indirect benefit to the transferor may support a denial of the exception.

Unfortunately for Kickstarter creators, these factors are present in nearly all Kickstarter transactions. On Kickstarter, there is a very specific process by which backers contribute to creators. Moreover, even a backer receiving a reward of nominal value is also receiving the indirect benefit of the project's completion. Like *Olk* and *Goodwin*, even if backers testified that they contributed out of a "detached and disinterested generosity," the transfers still would not qualify for the gift exclusion under § 102(a).

However, this is not apparent to creators, and they do not have an easy way of researching the issue. Their best course of action would be to seek professional tax advice, which will not be in the budget for most projects. When the temptation of reducing their tax burden is combined with misinformation on the availability of the gift exclusion, as well as the unclear legal nature of Kickstarter transactions, creators are likely putting themselves at risk.

---

130 *Kickstarter and Taxes*, *supra* note 126.

131 *Id.*

132 *See supra* text accompanying notes 122–123.

Looking at the whole picture, it is easy to understand how a creator could wrongfully characterize taxable income as a nontaxable gift. The process starts with transactions that do not resemble traditional sales. Most creators likely would not attempt to characterize a contribution as a nontaxable gift when the backer receives a tangible reward of roughly equivalent value. This feels like a sale, and creators would have a difficult time arguing anything different. However, if creators observe that a significant portion of their contributions came from backers receiving items of nominal value, it is a short leap to believe that those transactions should not be taxed.

If a creator comes to this conclusion, the belief that those contributions were nontaxable gifts is only further reinforced by Kickstarter's suggestions to that point. After all, if the creator did not provide any tangible reward to the backer, then what other motivation could the backer possess other than a "detached and disinterested generosity."

IV. CONCLUSION

Simply put, the problem for Kickstarter creators is the incentive to use the gift exclusion under § 102(a) when they should not. The unclear legal nature of Kickstarter transactions encourages this activity. Kickstarter itself encourages this by suggesting it in its tax materials. Furthermore, the confusing jurisprudence surrounding the definition of a "gift" for tax purposes is also problematic. The combination of these elements is the cause of the temptation faced by the creator.

A further problem is that the party who could remedy this problem with ease has no incentive to do so. Kickstarter could easily solve this problem by explicitly stating that creators should not attempt to utilize the gift exclusion. However, given that Kickstarter rarely mentions the tax consequences of contributions, it seems that it may want to downplay that aspect of its service. Backers are enticed to contribute because they want to see a project succeed. If Kickstarter advertised that a portion of backers' contributions would be taxed, some backers may not give at all. For a company that applies a fee to the total contributions, there is no incentive to bring to light a fact that may reduce revenue.

Yet, Kickstarter should still take this step. While there has not yet been a Kickstarter creator faced with serious tax consequences, commentators are discussing this risk.[133] Moreover, once this does occur, people considering utilizing Kickstarter to fund a project will be more fearful, knowing the potential tax risks involved. Therefore, in the long run, advising creators to be as conservative as possible regarding the use of tax

[133] *See, e.g.*, Suw Charman-Anderson, *Kickstarter's Sting in the Tail: Tax*, FORBES (May 23, 2012), www.forbes.com/sites/suwcharmananderson/2012/05/23/kickstarters-sting-in-the-tail-tax/.

exclusions is beneficial for the company, including advising creators to forego using the gift exclusion.

