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Revisiting Tax Liability for Receipt of Crowdfunding Donations and Government Grants

In March of this year the Internal Revenue Service reminded businesses that have received crowdfunding donations that those donations may be taxable as income to the recipient business. [FS-2022-20]. To qualify for exemption from the general rule that all income from whatever source is taxable to the recipient, the IRS noted that the contributions must be made “as a result of the contributors’ detached and disinterested generosity, and without the contributors receiving or expecting anything in return.” Contributions to crowdfunding, the IRS continued, may not have this level of disinterested generosity and would thus would be taxable to the recipient. Businesses receiving such crowdfunding contributions were advised to consult their professional tax advisor.

Another issue with a longer history is the tax liability for receipt of federal government grants. Again the starting point is that a federal grant is ordinarily taxable to the recipient unless the stated otherwise in the grant’s authorizing legislation. An exception to that rule emerged in the 1950 U.S. Supreme Court case of Brown Shoe, Inc. v. Commissioner (339 U.S. 583). There the Supreme Court held that payments received by Brown Shoe from a local community as an incentive to locate its plant in the community were “contributions to capital” by nonshareholders and could be excluded from Brown Shoe’s income. In 1954 the Internal Revenue Code Section 118 essentially codified this holding.

But the 2017 Tax Cuts and Jobs Act removed from the definition of “contribution to the capital of the Taxpayer” the language on “any contribution by any governmental entity or civic group.” In short, making grant receipts from government entities or civic groups taxable to the recipient as gross income.

As above, interested and affected parties are advised to contact their professional tax advisor.
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