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The Taxation of Crowdfunding for Medical Care

In September 2015, sixteen-year-old Jasiel Favors broke three vertebrae during a junior-varsity football game in Round Rock, Texas. He was left quadriplegic. Not only did Favors's sudden and tragic injury impose tremendous psychic costs, but Favors's family also bore immense monetary costs for his care: six hours of emergency spinal surgery, ninety days in the hospital followed by several subsequent rehospitalizations, physical therapy projected to continue for more than a decade, long-term assistance with virtually all activities of daily living, a custom wheelchair, and a laundry list of other medical items. And the indirect economic costs of Favors's injury stretched even further. Favors's mother took three months of unpaid leave from her job, which she then lost when Favors suffered complications. Although Favors had health insurance at the time of his injury, his family's out-of-pocket costs for his medical care exceeded $100,000. Then, when Favors's mother lost her job, Favors went uninsured for a time.

To cover the direct and indirect monetary costs of Favors's injury, Favors's family turned to crowdfunding. Two days after Favors's injury, a family friend set up a GoFundMe page on behalf of Favors's mother. Ten months later, a second GoFundMe page was started, which focused on the specific goal of securing an accessible van for transporting Favors. Finally, six months later, a third GoFundMe page asked for donations towards the costs of a subsequent rehospitalization. In total, these pages raised almost $34,000 from more than 350 donors, only a handful of whom gave more than $250. Favors also received donations outside of GoFundMe, most notably $29,000 from a local business to complete the purchase of Favors's van. According to Favors's mother, the money raised through GoFundMe was essential not only to Favors's medical care but also to the family's survival: these amounts "helped pay for rent and the lights [as well as] the medication."[1] Favors's reliance on crowdfunding is not exceptional; over the last decade, various crowdfunding platforms—GoFundMe, YouCaring, GiveForward, Generosity by Indiegogo, Fundly, FundRazr, and MightyCause—have raised billions of dollars for hundreds of thousands of individuals with medical needs.[2] And these dollars may have significant effects: one academic paper claims that GiveForward's cash transfers potentially reduced medical bankruptcies in the United States by almost 4% annually.[3]

Academic work on medical crowdfunding has focused primarily on crowdfunding's various shortcomings compared to broad-based public health provisioning. Medical crowdfunding may allocate scare resources inefficiently. Some campaigns focus on experimental, ineffective, or risky treatments (at least by today's medical standards), while others are simply fraudulent.[4] Bias and equity are persistent concerns in medical crowdfunding. Anyone can start a campaign, but success

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[1] See Kelsey McKinney, The Recovery of Jasiel Favors, SBNation (Sept. 28, 2017).

[2] This list has grown shorter over the last few years, as the industry has consolidated. Most notably, GoFundMe, a for-profit company, acquired YouCaring and GiveForward, both nonprofit enterprises, as well as Crowdrise, a platform for aggregating contributions for tax-qualified nonprofits. YouCaring had previously acquired Generosity, a personal crowdfunding platform created by Indiegogo.

[3] Gordon Burtch & Jason Chan, Reducing Medical Bankruptcy Through Crowdfunding: Evidence from GiveForward, Thirty Fifth International Conference on Information Systems, Auckland 2014.

[4] Studies critique crowdfunding for medical care such as homeopathy or naturopathy for cancer, hyperbaric oxygen therapy for brain injury, stem cell therapy for brain and spinal cord injury, and long-term antibiotic therapy for chronic Lyme disease.

follows clicks. Marketing and technical sophistication, pre-existing social networks, and media coverage tend to yield greater contributions. Race, class, and gender interplay with these factors. Furthermore, medical crowdfunding necessarily compromises individuals' privacy. Many platforms function as social media vehicles, in which beneficiaries establish or maintain reciprocal relationships with funders. Finally, advocates and researchers note that medical crowdfunding may alleviate societal pressure for much-needed systemic reform. But, at the end of the day, medical crowdfunding really does help individuals in crisis, and platforms seem likely to remain durable as Internet-age mechanisms for soliciting and aggregating small personal contributions.

In terms of tax, the legal literature has approached medical crowdfunding in the context of crowdfunding more generally—as a subset of personal or donation-based crowdfunding, and as a corollary of equity (or investment-based) and rewards-based crowdfunding. I argue that attempting to rationalize a holistic tax law of crowdfunding is somewhat misguided and likely unsatisfying. In addition, the tax treatment of medical crowdfunding is clouded by unresolved (or unresolvable) debates about the appropriate treatment of both gifts and medical expenses under an ideal income tax base. Instead, the legal and normative tax consequences of crowdfunding should depend on how medical crowdfunding meshes with the myriad exemptions and benefits that the Internal Revenue Code currently attaches to medical care. This second-best approach takes the current tax policy landscape as fixed (albeit imperfect and patchwork), then asks how medical crowdfunding best fits.

The *prima facie* tax treatment of medical crowdfunding is relatively straightforward. The Supreme Court in *Duberstein*[5] famously held that gifts are transfers that proceed from "a detached and disinterested generosity" and "out of affection, respect, admiration, charity or like impulses." The purported donor's "intention" is "most critical." Essentially, both the donor and the recipient's tax consequences turn on the donor's state of mind at the time of the transfer. Under this standard, contributions through medical crowdfunding websites would appear to be personal gifts—nondeductible for the donor and not includible by the donee. Crowdfunding platforms generally state this position on their websites, with appropriate caveats, and, in a well-traveled 2016 information letter, the IRS explicitly acknowledged the possibility of gift treatment for donation-based crowdfunding.

This superficially simple treatment is complicated by three common characteristics of crowdfunding platforms: these platforms are impersonal, institutionalized, and market-driven. These characteristics distinguish platform-based crowdfunding from less formal mechanisms for aggregating contributions, such as mail-in campaigns sparked by media attention,[6] collection-plate efforts mediated by community-based religious or social organizations, or direct donations from local businesses. Crowdfunding represents a significant departure from (and supplement to) these informal mechanisms, which typically operated outside of conventional tax oversight.

Although medical crowdfunding is intensely personal in terms of substance, the process is relatively impersonal. Funders may not have real-world family, social, or professional connections to the beneficiary, and funders may choose to remain anonymous. These features—and they are

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[5] 363 U.S. 278 (1960).

[6] A well-known example involves 18-month-old Jessica McClure, who fell down a well in 1987. National television coverage of her rescue sparked over $700,000 of contributions, mostly from people outside of McClure's community.

touted as such by crowdfunding platforms—make it hard, in a strict sense, to adduce more than circumstantial evidence to support a gift under the *Duberstein* standard.[7] This complication introduces uncertainty.[8] In addition, crowdfunding platforms are impersonal in the sense that they interpose a number of intermediaries between funders and beneficiaries. Funders use platforms to identify beneficiaries, and the platforms use third-party processors—for example, WePay, Paypal, and Stripe—to handle payments and hold funds. Then, the processors disburse the funds to the campaign organizers, who often are friends or family members of the ultimate beneficiaries. In many cases, these organizers may function as agents of the beneficiaries. There are possible exceptions, however, where organizers operate without the beneficiaries' knowledge or exercise dominion and control over the campaign funds. In these situations, the organizers may have income under the *Duberstein* standard, since any donative intent arguably applies only to the beneficiary.[9] Although analog gift-giving faces similar questions of agency, platforms both exacerbate and make visible these issues.

Furthermore, medical crowdfunding is institutionalized, especially compared to informal, community-mediated mechanisms of health care provisioning. For example, payment processors potentially introduce a layer of information reporting for medical crowdfunding. The Code generally requires processors to issue Forms 1099-K to individuals who receive, in a single year, payments from more than 200 funders that exceed $20,000 in the aggregate.[10] These thresholds apply without regard to the number of campaigns or beneficiaries involved. In practice, however, information reporting depends significantly on the processor. WePay takes the position, after informal consultation with the IRS, that it need not issue Forms 1099-K for payments "made solely as gifts or donations." By contrast, PayPal issues Forms 1099-K for payments for "goods and services," and Stripe appears to issue Forms 1099-K regardless of payment type. Although information reporting is not dispositive as to whether an item actually is income, failure to adequately account for these Forms 1099-K may trigger—and, based on anecdotal reports, has triggered—IRS scrutiny.[11]

Finally, crowdfunding platforms are simultaneously community-oriented and market-driven. To a significant extent, these platforms simply change how gifts are made, compared to less formal methods of aggregating contributions. Crowdfunding lowers transaction costs to donors while increasing such costs to donees. Platforms and payment processors make giving easy, but they collect or request fees with respect to each contribution.[12] At the end of the day, these platforms facilitate the type of informal social insurance that conventionally falls (and historically has fallen)

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[7] For example, an employer might contribute anonymously to an employee's medical crowdfunding campaign. This contribution could be compensatory or out of detached and disinterested generosity.

[8] See, e.g., Goodwin v. United States, 67 F.3d 149 (8th Cir. 1995); Webber v. Comm'r, 219 F.2d 834 (10th Cir. 1955).

[9] For example, an organizer who successfully bets all of a beneficiary's crowdfunding proceeds on a sporting event presumably has income on both the receipt of funds and any winnings, if the organizer makes the bet without the beneficiary's approval.

[10] Vermont and Massachusetts have reporting requirements with a much lower dollar threshold ($600) and no minimum number of transactions.

[11] Determining the resolution of these inquiries is difficult.

[12] Pricing for crowdfunding platforms also generally has converged on a model in which beneficiaries receive donated funds, less payment processing fees, and funders are given the opportunity to leave an additional "tip" for the platform. Some platforms, however, continue to charge a percentage fee on top of payment processing fees.

under the "gift" paradigm. But platforms also may reach funders outside of the beneficiary's community. In a sense, platforms create and institutionalize a competitive market that brings together the buyers and sellers of charity. Although contributions in this type of market may satisfy the *Duberstein* standard for gifts, such contributions—especially if they represent a substantial portion of a person's resources—may appear less gift-like and more like the fruits of one's labor, or the rewards to a form of celebrity. The market-driven aspects of donation-based crowdfunding are compounded by the fact that, while an underlying medical problem may motivate funders, the proceeds of a campaign may compensate beneficiaries for medical expenses, pain and suffering, or lost wages, among other things. In other contexts, tax law treats these categories differently.

The impersonal, institutionalized, and market-driven nature of medical crowdfunding, as well as the policy uncertainty surrounding the appropriate tax treatment of gifts, invites a more holistic consideration of how medical crowdfunding does and should fit with other tax benefits for health care. Illustrative of this approach are two (nonexhaustive) points of comparison: employer-provided health and disability insurance and recoveries for personal injuries or sickness.

Under current law, premiums for employer-provided health insurance are deductible by employers and not includible by employees. Payments under these plans are excludible from the beneficiary's income to the extent they relate to medical expenses or permanent bodily impairment or disfigurement. Employer-provided short- and long-term disability insurance is treated differently. If premiums are includible by employees or paid out of employees' after-tax income, then benefits are excludible. If premiums are excludible or paid with pre-tax dollars, then benefits are includible. In either case, any premiums paid by employers are deductible. Taken together, these rules essentially exclude payments for medical expenses from income tax base from both the funders' and the beneficiaries' perspectives, while imposing tax—either coming or going—on the beneficiary with respect to payments that substantially replace wages.[13]

By contrast, a broader exclusion applies to recoveries by lawsuit or settlement for damages "on account of personal physical injuries or physical sickness." Such recoveries are excludible from the recipient's income regardless of whether the payor intends to compensate the recipient for medical expenses, pain and suffering, or lost wages, and regardless of whether the recipient actually uses the funds for any specified purpose. Some evidence indicates that juries and payors may reduce (gross) recoveries for lost wages to account for the exclusion, which would shift part or all of the tax benefit to the payor—an implicit tax on the recipient with respect to amounts not devoted to medical expenses and pain and suffering. From the payor's perspective, the deductibility of recovery payments (or premiums, if the recovery is paid through insurance) depends on whether the claim relates to business or personal activities. Overall, however, the landscape for personal injury recoveries yields a practical distinction between medical-related expenses and personal consumption.

Medical crowdfunding produces a somewhat less favorable tax result than either employer-provided health and disability insurance or recoveries for personal injuries or sickness. This result stems from several factors. First, if the proceeds of medical crowdfunding do not represent a gift for tax purposes (or if gift treatment is uncertain), then medical crowdfunding produces significant beneficiary-level taxable income that would be excludible in other contexts. Second, even if

[13] It is unclear whether, or when, § 213 deductions are available in the context of disability insurance payments.

medical crowdfunding is treated as a gift, crowdfunding donors generally cannot deduct amounts transferred to the recipient. The effect is substitute taxation—likely at a rate higher than the recipient's—on amounts that relate to both medical expenses and personal consumption. Essentially, medical expenses and personal consumption are subject to one level of tax.

The provision most likely to provide (partial) relief from taxation on medical expenses, § 213, may be unavailable to the beneficiaries of crowdfunding.[14] To the extent that the proceeds of medical crowdfunding vary directly with need and inversely with income, the § 213 personal deduction for medical and long-term care expenses may provide little relief. Low-income beneficiaries will have large potential deductions but little income, while higher-income beneficiaries will have small potential deductions that may be largely or completely absorbed by § 213's floor, which currently equals 10% of a taxpayer's adjusted gross income. These outcomes point to a problem inherent in substitute taxation, which separates taxable income from corresponding deductions. In addition, § 213 is available only for expenses "not compensated for by insurance or otherwise." To the extent that medical crowdfunding "otherwise" compensates for medical expenses (and there is some indirect authority that it might), no deduction is available to the beneficiaries of such arrangements.

In order to "fit" medical crowdfunding into existing tax preferences for health care, Congress or Treasury could clarify that medical crowdfunding is not "otherwise" compensation for purposes of § 213. Since 2017, Treasury has included an item in its Priority Guidance Plan on guidance on medical crowdfunding and the gift exclusion; this guidance also should address the interpretation of § 213. Although § 213 does not fully exclude medical and long-term care expenses from the tax base (or, of course, compensation for pain and suffering), the provision would help harmonize outcomes between medical crowdfunding and other aspects of the tax system. Taking the 10% floor as administratively necessary, Congress could consider implementing carrybacks and carryforwards for medical expense deductions that are unusable in the current year, which would alleviate mismatches of income and medical expenses that medical crowdfunding generates. In the absence of fundamental reform, these changes would better integrate medical crowdfunding into the current tax treatment of medical care.

[14] Also, beneficiaries clearly cannot § 213 deductions for crowdfunded amounts that compensate for pain and suffering.