Direct Cash Transfers and Tax Policy

Reporting cash transfers for maximum benefit to the recipients

Jacqueline Lainez Flanagan[1] | November 2022

Unconditional direct cash transfers (DCTs) are supported by a vast national and international evidence base. They have been shown to have a positive impact on health outcomes, school attendance, child development, household spending, and poverty reduction (Morton et. al., 2020). For young people experiencing homelessness or housing instability, DCTs offer a promising approach for moving swiftly to safe, permanent housing and starting on pathways to independence. While a DCT can be an important source of support and financial safety net, there is currently no express exemption from income for DCTs, potentially impacting a young person's tax burden. Ultimately, this could erode the net benefit of a pilot program and possibly produce new forms of inequality (Baker et al., 2020).

Currently, several cities and counties throughout the U.S. are considering DCTs as an intervention to end youth homelessness. Many are designing these interventions as a cash gift, structured so that the regular cash payment from a nonprofit to a young person experiencing homelessness proceeds from "detached and disinterested generosity" and "out of. . . charity or like impulses" (*Commissioner v. Duberstein*, 1960; Kahn, 2018).[2] This paper analyzes this interpretation and current income exclusions in the tax code analogous to DCTs. There is not an explicit tax code section that directly addresses the tax treatment of DCTs. However, existing exemptions from income provide a framework for supporting the exclusion of DCTs from gross income, so long as the payments are not compensation for services, and are distributed out of detached, disinterested generosity to address a recipient's financial need. Ideally, express federal and state legislative guidance will be forthcoming to direct revenue agencies, DCT providers, and fund recipients how unconditional DCTs should be treated.

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[2] The transferor's (donor's) intent is an important factor in considering whether a transfer is a gift.

CHAPIN HALL AT THE UNIVERSITY OF CHICAGO | Youth Accelerator

The general tax implications of narrowly tailored direct cash transfers should be considered by DCT programs, mindful that fund recipients may need to seek professional tax advice about how to proceed absent broad revenue agency guidance.

HIGHLIGHTS:

- Payments made by nonprofits providing no strings attached DCT funds to young people experiencing homelessness should be characterized as need-based financial benefits excluded from taxable income. This reflects existing tax law, including American Rescue Plan Act aid, disaster relief payments, low-income tax credits, cash payments that qualify as gifts, and public benefit programs like Temporary Assistance for Needy Families (TANF).
- However, under current federal tax laws, there is no express guidance from the IRS stating DCTs can categorically be excluded from income.
- Federal and state tax agencies need to provide guidance specifically addressing the tax treatment of DCTs. This will offer DCT recipients, program funders, and program administrators greater certainty. The guidance should include whether DCTs should be categorically excluded from income as gifts or whether they otherwise qualify for exclusion and exemption from recognition as income.
- DCT programs seeking to exclude DCTs from income should develop best practices in disseminating DCT funds. For example, administrators should ensure that payments to DCT recipients are distributed out of detached, disinterested generosity and not as compensation for services rendered. When in doubt about any related tax responsibilities, DCT programs should seek professional tax guidance and include disclaimers advising DCT recipients to seek professional tax advice for case-specific tax counseling.

ABSTRACT

To maximize the benefit of DCT programs across the country, federal and state legislatures and revenue agencies should provide express guidance regarding the exclusion of DCT payments from calculations of gross income. While existing codified exclusions to income indicate these payments qualify for exclusion based on the charitable nature of the funds—and should not constitute taxable income to recipients—no express tax guidance currently exists. American Rescue Plan economic relief funds, nontaxable gifts, need-based tax credits, and other current income-exempt economic stimulus payments provide guidance indicating DCTs are not taxable. Federal and state revenue agencies, legislators, and policymakers should use this guidance to develop nontaxable direct cash transfer guidelines. Until express guidance is available, direct cash transfer recipients and program administrators should consult with appropriate tax professionals and revenue agencies to ensure they are complying with all applicable state and federal tax requirements.

INTRODUCTION

This paper presents research related to the growth of direct cash transfer (DCT) programs in the United States, isolating the following key tax issues: Direct cash transfers, specifically to young people aged 18 to 24 experiencing homelessness, should not constitute taxable income as long as the payments are not compensation for services and are distributed out of detached, disinterested generosity. The general tax implications of narrowly tailored direct cash transfers should be considered by DCT programs, mindful that fund recipients may need to seek professional tax advice about how to proceed absent broad revenue agency guidance.

There is currently no direct guidance from the Internal Revenue Service (IRS) or states regarding the tax treatment of direct cash transfers. As such, there is no guidance concerning the tax implications of such transfers for recipients, funders, and organizations administering the payments. This white paper provides a better understanding of how direct cash transfers might be treated under the current tax code and analyzes how different factors could potentially affect the tax treatment of these payments.

Unconditional DCTs based on financial need should not constitute taxable income to recipients due to the charitable intent of the funds. However, DCT funds are currently not expressly excluded from being recognized as income. An express exclusion from income would allow a recipient of DCT funds based on need to not report the funds as income, thus shielding the funds from potential taxation. The only current tax exemption, at the federal level, is where the DCT funds otherwise qualify for a preexisting exclusion (for example, where American Rescue Plan COVID-19 relief funds are distributed as a DCT). Some states, such as California, are beginning to pass legislation exempting precisely defined guaranteed income for specific populations (for example, transitioning and parenting youth) from income recognition for tax purposes. This legislation has not yet specifically named DCTs.[3] Illinois has expressly exempted *cash transfers* from affecting other public benefits but has stopped short of directing the tax treatment of DCTs (Act to Amend the Social Service Law, 2022; Illinois Public Aid Code, 2019).

According to the current U.S. tax code certain aid payments— namely aid payments by the government, charitable organizations, and private entities—are not recognized as income. These existing exclusions provide the basis for the recommendation that state and federal revenue agencies should expressly exclude unconditional DCT funds from taxable income as long as they serve a charitable purpose and are not compensation for services (in other words, they are not disguised wages).

Unconditional DCTs, essentially by definition, are designed and intended to provide financial assistance to those in need. Thus, existing taxable income exclusions in the U.S. tax code, intended to alleviate poverty and promote self-sufficiency, provide the guidance and framework for potential best practices moving forward. This white paper appeals for certainty regarding the tax treatment of unconditional direct cash transfers that serve a quasi-governmental public good. It concludes with recommendations to maximize the impact of these payments and reduce potential associated tax burdens.

[3] See California Budget 2022–2023, excluding "any payments received by an individual from a guaranteed income pilot program or project from the gross income of recipients for personal income tax purposes" until July 1, 2026, https://www.ebudget.ca.gov

WHAT ARE DIRECT CASH TRANSFERS?

DCT programs pay a fixed amount of money directly to individuals in need of financial assistance, typically without conditions or restrictions dictating how the funds may be spent (Innovations for Poverty Action, n.d.). DCT programs have been successful internationally and range from one-time lump sum payments to periodic payments for a specified duration (Chowdhury et al., 2022). They are paid in the form of cash or check through various payment methods (direct deposit, electronic, or prepaid debit card, among others) rather than a voucher.

U.S.-BASED DIRECT CASH TRANSFER PILOTS

DCT programs, including pilot programs and related research studies, are currently launching across the United States (Morton et al., 2020). Dictated by growing inequities and in part as a response to the disparate impact of the COVID-19 pandemic, several U.S. cities initiated direct cash transfer programs and pilots. The target population of most direct cash transfer pilots and demonstration projects in the U.S. includes the working poor, those experiencing homelessness, individuals disproportionately impacted by the ongoing COVID-19 pandemic, and families struggling with any of these issues. For example, in 2019 the city of Stockton, California launched the Stockton Economic Empowerment Demonstration (SEED) program that provided unconditional payments of $500 each month for 24 months to 125 randomly selected households in ZIP codes with area-level income under the median of $46,033. SEED published the results of their program, which demonstrated improvement in the lives of recipients across several categories. New York City announced their Trust Youth Initiative during the summer of 2021. The first phase of the project would distribute unconditional direct cash transfers of about $1,100 per month for up to 2 years to young people between the ages of 18 and 24 experiencing homelessness to invest in themselves and their housing (Chapin Hall, 2021). In Washington, DC, the Greater Washington Community Foundation distributed $26 million to 60,000 residents in the metro DC area to address the economic repercussions of the COVID-19 pandemic. Funds were given in increments between $50 and $2,500. A particular focus of the distribution was those without a financial safety net, including undocumented people, frontline essential workers, and returning citizens.

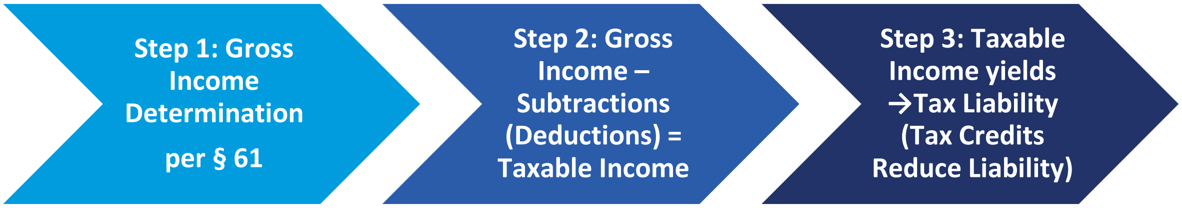
Many of the current pilots and demonstration projects in the U.S. distribute unconditional direct cash transfers to recipients in the form of a cash gift, specifically emanating from "detached and disinterested generosity. . . out of affection, respect, admiration, charity or like impulses" (*Commissioner v. Duberstein*, 1960). Absent express guidance from federal and state tax agencies on the treatment of DCT funds, the following section provides a general overview of U.S. taxation and exclusions from income determination that support the treatment of DCTs as a cash gift.

OVERVIEW OF TAXATION IN THE U.S.

TAXABLE INCOME AND EXCLUSION FROM INCOME DETERMINATION

The Internal Revenue Code ("IRC" or "Code") is comprised of existing tax laws outlining, inter alia, when taxpayers must pay federal income tax on their taxable income. The "taxable income" computation begins with the identification of a taxpayer's "gross income" (described below). The Code sets forth various deductions or subtractions from gross income to arrive at a taxpayer's "taxable income." Income tax liability is then determined using IRS tax tables. After federal income tax liability is determined, applicable tax credits can reduce taxes owed.

Figure 1. Determination of Taxable Income and Tax Liability



The Internal Revenue Service (IRS) is responsible for administering federal tax laws codified in the IRC and for collecting taxes in the United States. The IRC provides a broad definition of gross income in section 61, stating, "Except as otherwise provided. . . gross income means all income from whatever source derived" (Gross Income Defined, n.d.).[4]

While this general definition does not address the question of what specifically counts as income, there are 14 examples of income included in this code section, including compensation for services; monetary gains from business or property, rents, royalties; and pension income. Another standard to evaluate a taxable gain, or whether something qualifies as gross income is the mandate to include "all accessions to wealth, whether realized in the form of cash, property or other economic benefit" (Montemurro, 2016).

CURRENT EXCLUSIONS FROM INCOME

Currently, there is no express exclusion in the tax code for DCTs. DCT parameters—including the intent behind the payments and the financial need of recipients—are important considerations when determining whether these funds should qualify for exclusion from taxable income. To help address the tax question of whether a direct cash transfer (DCT) should constitute taxable income to a recipient, the following existing exclusions from income provide helpful comparisons.

PRIVATE GIFT EXCLUSION UNDER IRC 102(A)

Congress makes policy choices surrounding how, when, and what to tax, and it has made several exceptions to taxable gross income, including certain gifts and scholarships.[5] For example, gifts of money, services, and personal property[6] can be excluded from individual income and treated as non-taxable if they qualify under the U.S. tax code gift exclusion (General Income Defined, n.d.; Kahn, 2018).[7] Section 102(a) states a gift "must proceed from a

[4] Including (but not limited to) the following items: (1) compensation for services, including fees, commissions, fringe benefits, and similar items; (2) gross income derived from business; (3) gains derived from dealings in property; (4) interest; (5) rents; (6) royalties; (7) dividends; (8) annuities; (9) income from life insurance and endowment contracts; (10) pensions; (11) income from discharge of indebtedness; (12) distributive share of partnership gross income; (13) income in respect of a decedent; and (14) income from an interest in an estate or trust.

[5] Another example of nontaxable income, besides gifts, are qualified transfers of funds from educational organizations (i.e., a scholarship). 26 U.S.C. § 2503(e)(1). "The term "qualified transfer" means any amount paid on behalf of an individual as tuition to an educational organization described in section 170(b)(1)(A)(ii) for the education or training of such individual." 26 U.S.C. § 2503 (e)(2)(A). An educational organization is defined as one "which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on." 26 U.S.C. § 170(b)(1)(A)(ii).

[6] Gifts can be goods: money, personal property (e.g., a car), or real property (e.g., a parcel of land). Gifts can also be services (e.g., a car wash).

[7] "The [gift] exclusion insures [*sic*] that there is a single income tax for a single consumption." However, the act of gifting "does not constitute consumption." *Id.*

detached and disinterested generosity,'. . . 'out of affection, respect, admiration, charity or like impulses.'" Otherwise, the gift is treated like income for the recipient and potentially taxable.

Box 1. IRS Guidance Regarding Gifts

"Generally, the person who receives a gift or bequest of property from an estate won't have to pay any federal gift tax or estate tax. Also, that person won't have to pay income tax on the value of the gift or inheritance received."

A "gift" is defined by the IRS as "any transfer to an individual, either directly or indirectly, where full consideration (measured in money or money's worth) is not received in return." Furthermore, "the donor is generally responsible for paying the gift tax."

(Internal Revenue Service, 2022d; Internal Revenue Service, 2021e, p. 24)

COVID-19 RELIEF FUNDS: AMERICAN RESCUE PLAN OF 2021

Coronavirus State and Local Fiscal Recovery Funds were established under the American Rescue Plan Act (ARP SLFR Funds), providing eligible state and local governments funding to respond to pandemic-related needs (Internal Revenue Service, 2021a). Importantly, the IRS recently issued guidance noting SLFR Funds do not constitute taxable income to recipients. However, caution should be exercised in relying on the information; currently it is only available in a frequently asked question (FAQ) format, not as formal published guidance.[8]

GOVERNMENT-BASED DISASTER RELIEF: SEC. 139 OF THE INTERNAL REVENUE SERVICE CODE

Government funds disbursed to address the impacts of COVID-19 generally categorically qualify as nontaxable disaster relief payments under section 139 of the Internal Revenue Service Code. Disaster relief declarations are generally issued by FEMA or by presidential decree and incorporate situations ranging from severe weather events to breaches in national security (Internal Revenue Service, n.d.-a; see Box 2).

at 190. "The exclusion of gifts is supported the optimum-utility-of-consumption and single-taxable- unit concepts. On the flip side, the taxation of gifts is supported by the principle that gifts represent an accretion of wealth that the donee will use to consume resources at some point. The issue is whether one principle must always triumph over the other. Congress chose to exclude gifts from income, and so it would seem that as long as the *Duberstein* standard is met, the gift must be excluded." *Id*. at 192.

[8] "Because these FAQs have not been published in the Internal Revenue Bulletin, they will not be relied on or used by the IRS to resolve a case. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability. Nonetheless, a taxpayer who reasonably and in good faith relies on these FAQs will not be subject to a penalty that provides a reasonable cause standard for relief, including a negligence penalty or other accuracy-related penalty, to the extent that reliance results in an underpayment of tax. Any later updates or modifications to these FAQs will be dated to enable taxpayers to confirm the date on which any changes to the FAQs were made. Additionally, prior versions of these FAQs will be maintained on IRS.gov to ensure that taxpayers, who may have relied on a prior version, can locate that version if they later need to do so (Internal Revenue Service, n.d.-a).

Box 2. IRS Guidance for American Rescue Plan Act Coronavirus State, and Local Recovery Funds

"The Coronavirus State and Local Fiscal Recovery Funds (SLFR Funds) provide eligible state and local governments with a substantial infusion of funds to meet pandemic response needs and rebuild a stronger and more equitable economy as the country recovers. The SLFR Funds provide substantial flexibility for each government to meet local needs—including support for households and individuals hardest hit by the crisis. . .

"Some uses of SLFR Funds may trigger tax consequences. In general, individuals must include in gross income any payment or accession to wealth from any source unless an exclusion applies. One exclusion is for qualified disaster relief payments under section 139 of the Internal Revenue Code (Code). Under section 139 of the Code, certain payments made by a state or local government to individuals in connection with the COVID-19 pandemic may be qualified disaster relief payments that are *excluded* from the recipient's gross income.

"A payment by a state or local government generally will be treated as a qualified disaster relief payment under section 139 if the payment is made to or 'for the benefit of'" an individual to:

(1) reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster, or

(2) promote the general welfare in connection with a qualified disaster. See section 139(b)(1) and (4).

As a federally declared disaster, the COVID-19 pandemic is considered a qualified disaster for purposes of section 139(c). However, payments are not treated as qualified disaster relief payments if the payments are in the nature of compensation for services performed by the individual" (Internal Revenue Service, 2021a).

EXCLUSION FROM INCOME: SEC. 6409

Government-issued tax refunds and refundable credits have an existing carve-out in section 6409 of the Internal Revenue Code, which generally exempts these payments from recognition as income to recipients, or from affecting other federal benefits (Refunds disregarded in the administration of Federal programs and federally assisted programs, n.d.). This includes public benefits administered through the tax system covering need-based payments like the Earned Income Tax Credit (EITC), the Child Tax Credit, and Advance Child Tax Credit (Internal Revenue Service, 2022a).

GOVERNMENT PUBLIC BENEFIT PAYMENTS: PUBLICATION 525 GUIDANCE

IRS Publication 525 notes that any federal stimulus payments or economic impact payments (EIP) are not taxable for federal income tax purposes (Internal Revenue Service, 2021b).[9] It also states "governmental benefit payments from a public welfare fund based upon need" are not considered taxable income and one who receives such a payment does not need to include the payment on a tax return (Internal Revenue Service, 2021b).

[9] But they may impact Recovery Rebate Credit (RRC) amounts: "Emergency financial aid grants. Certain emergency financial aid grants under the CARES Act are excluded from the income of college and university students, effective for grants made after 3/26/2020. (See P.L. 116-136 and P.L. 116-260.) Economic impact payments. Any economic impact payments you received are not taxable for federal income tax purposes, but they reduce your recovery rebate credit. Other loan forgiveness under the CARES Act. Gross income does not include any amount arising from the forgiveness of certain loans, emergency Economic Injury Disaster Loan (EIDL) grants, and certain loan repayment assistance, each as provided by the CARES Act, effective for tax years ending after 3/27/2020" (Internal Revenue Service, 2021d).

TANF AND SOCIAL BENEFIT PAYMENTS: PUBLICATION N-99-3

Social benefit programs like Temporary Assistance for Needy Families (TANF) cash payments, or targeted food subsidies like the Supplemental Nutrition Assistance Program (SNAP), also known as food stamps, are also not considered gross income for tax purposes. Thus, the payments are not reported on a personal income tax return and are not taxed (Hoynes & Schanzenbach, 2020; Internal Revenue Service, n.d.-c; Office of Family Assistance, 2022).[10]

EMERGENCY RENTAL ASSISTANCE

Emergency rental assistance is included in the social benefit payments eligible for coronavirus tax relief (American Rescue Plan Act, 2021; Consolidated Appropriation Act, 2021). [11] Congress enacted legislation in late 2020 and early 2021 appropriating funds to provide direct financial assistance in the form of payments related to housing, utilities, home energy bills and related costs. Shortly thereafter, the IRS issued guidance noting these payments are not included in the recipient's gross income, whether the individual received the payments directly, or whether a landlord or utility company received the payments on behalf of eligible households.

Box 3. Gross Income Exclusion for Social Benefit Payments

"Payments by a governmental unit to an individual under a legislatively provided social benefit program for the promotion of the general welfare that are not basically for services rendered are not includible in the individual's gross income and are not wages for employment tax purposes, even if the individual is required to perform certain activities to remain eligible for the payments."

Internal Revenue Service, n.d.-d. Rev. Rul. 71-425, 1971-2 C.B. 76; Rev. Rul. 75-246, 1975-1 C.B. 24

IRS LETTER RULING – ADOPTION FEES PAID BY NONPROFITS

In 2006, the IRS issued a nonbinding private letter ruling (see text box below), which directly addressed the issue of a tax-exempt organization providing nontaxable payments to individuals.

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[10] See Rev. Rul. 71-425, 1971-2 C.B. 76; Rev. Rul. 75-246, 1975-1 C.B. 24.

[11] Section 501, Division N, of the Consolidated Appropriations Act allows States and political subdivisions, U.S. territories, Indian Tribes, and the Department of Hawaiian Homelands ("Distributing Entity") to use certain funds allocated by the Department of the Treasury to provide financial assistance to households to pay rent, utilities, home energy expenses, and other related expenses. Section 3201 of the American Rescue Plan Act of 2021 appropriates additional funds for States, political subdivisions, and U.S. territories to provide financial assistance to households to pay rent, utilities, home energy expenses, and other related expenses. Payments under either provision are referred to as "Emergency Rental Assistance" (Internal Revenue Service, 2021c).

Box 4. Internal Revenue Service - Private Letter Rulings

"A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR is issued to establish with certainty the federal tax consequences of a particular transaction before the transaction is consummated or before the taxpayer's return is filed. A PLR is issued in response to a written request submitted by a taxpayer and is binding on the IRS if the taxpayer fully and accurately described the proposed transaction in the request and carries out the transaction as described. A PLR may not be relied on as precedent by other taxpayers or IRS personnel. PLRs are generally made public after all information has been removed that could identify the taxpayer to whom it was issued."

(Internal Revenue Service, 2022b)

In IRS Letter 2006-0027 (the Letter), the agency examined whether adoption fees provided by a nonprofit counted as gross income and could therefore be taxed (Montemurro, 2005). In particular, the letter addressed "whether payments made by a tax-exempt organization, pursuant to its purpose statement, to help individuals in need pay for the cost of an adoption are included in the individuals' gross income or subject to information reporting" (Montemurro, 2005). The letter relied on two prior Revenue Rulings in making its determination that payments made by tax-exempt organizations, pursuant to their purpose statement, may be excluded from gross income (Montemurro, 2005).[12]

PAYMENTS MADE BY PRIVATE DONORS AND CROWDFUNDING PLATFORMS

Online "crowdfunding" platforms (platforms for fundraising; Luke, 2017)[13] have long argued that the funds raised constitute "private gifts" and therefore are not taxable for recipients (Kahn, 2018; Luke, 2017). [14] Generally, donations

[12] The first ruling relied upon considered whether a grant received by an individual from a charitable organization's disaster relief program was considered gross income. The IRS found that these types of grants are "designed to help" with distressed individuals' unreimbursed expenses that occurred "as a result of a flood." Therefore, the payments were "made out of detached and disinterested generosity rather than to fulfill any moral or legal duty." The second referenced ruling held that "in general, a payment made by a charity to an individual that responds to the individual's needs and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity." These two rulings together hold that the payments could be excluded from gross income under IRC § 102. After examining the two revenue rulings, the IRS found the payments in the revenue rulings are analogous to the adoption fees, and therefore those fees could be considered gifts, making them non-taxable. In addition, the payments need not be included in "the recipient's gross income" nor included in information reporting "if the payments are made directly to the needy individuals." Situation 2 of Rev. Rul. 2003-12, 2003-1 C.B. 283. Rev. Rul. 2003-12 also concludes that the amounts excluded from gross income under the ruling are not subject to information reporting under § 6041. Rev. Rul. 99-44, 1999-2 C.B. 549. f

[13] There are four different types of crowdfunding: donation-based, reward-based, equity-based, debt-based. Donation-based funding is raised without promising anything in return and is often raised for the "payment of personal necessities." Donation-based crowdfunding can be classified as "need-oriented" or "patronage oriented." "Need-oriented, donation-based crowdfunding likely fits into the 'gift' tax category." The tax treatment of "patronage-oriented" crowdfunding is less clear, but it is "more likely to be taxable income to the recipient."

[14] "[G]ift transfers are not included in the income of the recipient but determining whether something is a gift depends on the context, and crowdfunding presents new contextual features to consider."

solicited by charities are treated as gifts because they "provide benefits to a large number of people and play a significant role in providing for the welfare of the public"(Kahn, 2018).

In essence, donations solicited by charities "have a quasi-governmental function" (Kahn, 2018). Online crowdfunding campaigns, on the other hand, typically benefit individuals (Luke, 2017).[15] GoFundMe, a nonprofit, is one of the most popular online crowdfunding tools (Kahn, 2018).

Donations raised on GoFundMe are generally treated as gifts (GoFundMe, 2022).[16] In addition, a GoFundMe user agrees to terms and conditions that they are not providing goods or services in exchange for the donation of funds. GoFundMe does not withhold any portion of collected funds for tax purposes (GoFundMe, 2022).[17] However, fund recipients are expressly advised: "It is your responsibility to determine what, if any, taxes apply to the Donations you receive through your use of the Services. It is solely your responsibility to assess, collect, report or remit the correct tax, if any, to the appropriate tax authority."

Moreover, in 2022, the IRS included additional guidance on the agency's website stressing the importance of a case-by-case analysis to determine the tax treatment of crowdsourced funds, noting: "Contributions to crowdfunding campaigns are not necessarily a result of detached and disinterested generosity, and therefore may not be gifts. Additionally, contributions to crowdfunding campaigns by an employer to, or for the benefit of, an employee are generally includible in the employee's gross income. Taxpayers may want to consult a trusted tax professional for information and advice regarding how to treat amounts received from crowdfunding campaigns" (GoFundMe, 2022).

REQUIREMENT OF NO *QUID PRO QUO*

"No *quid pro quo*"[18] requirements mean there cannot be an exchange of services or goods for the funds. GoFundMe campaigns generally qualify as gifts because fundraisers are not offering anything in exchange for the funds, meaning there is no *quid pro quo* (Kahn, 2018). As previously noted in the 102(a) gift exclusion, the person donating funds is likely contributing money based on generosity and not in exchange for a service (Taxable Gifts, n.d.). Whether the contribution is a gift depends on the totality of the circumstances; not every transfer without a *quid pro quo* necessarily constitutes a nontaxable gift.

[15] "As crowdfunding continues to evolve, administrative guidance and safe harbors applying current law to the various types of projects, project creators, and project contributors would provide taxpayers with greater certainty and facilitate administration."

[16] "Donations made to personal GoFundMe fundraisers are generally considered to be 'personal gifts' which, for the most part, are not taxed as income in the United States. Additionally, despite the organization's nonprofit status, these donations are not tax deductible for donors."

[17] "Donations made to personal GoFundMe fundraisers are generally considered to be "personal gifts" which, for the most part, are not taxed as income in the United States. Additionally, these donations are not tax deductible for donors. However, there may be case-specific instances where the income is in fact taxable for organizers. For example, if the donations are considered income to the recipient. The best way to ensure that you are in compliance with the tax laws is to maintain adequate records of donations received and consult with a tax professional." (emphasis added; GoFundMe, 2022)

[18] As well as the disinterested, charitable purpose standard of gifts excluded from income (for recipients).

IMPLICATIONS FOR DIRECT CASH TRANSFERS

DCT PARAMETERS - INTENT AND FINANCIAL NEED OF RECIPIENTS

Based on existing exclusions from income for gifts, government assistance such as disaster relief payments, excludable tax credits, and charitable funds disseminated by nonprofits to those in need, DCTs should be similarly exempt from recognition as taxable income.

Absent the addition of a categorical exclusion in the tax code, it would be important to consider the following when structuring a direct cash transfer program:

- The amount of the cash transfer. Under the 102(a) gift exclusion, the dollar amount of DCTs does not have implications for recipients, but for the individual giver. IRC 2503 generally outlines the amount a single person can gift to another person in one tax year (TY) and any amount over that is taxed (Taxable gifts, n.d.).19 The gift amount is adjusted every year for inflation, with the limit for TY 2022 set at $16,000 (Taxable gifts, n.d.). For any amount gifted over the yearly limit per individual, the donor is subject to taxation. In addition, there is also a lifetime limit of how much someone can gift without being taxed—about $11.7 million in TY2021 (Internal Revenue Service, n.d.-b).

- Source of payments to youth, young adults and families. The source of the payment can be consequential for determining the taxable nature of a DCT. ARPA dollars and other federally funded payments (tax credits and public benefits) are important examples. Under current tax law, DCTs distributed by nonprofits and comprised solely of COVID-19 funds or similar economic relief previously deemed nontaxable are not counted as taxable income and are not subject to personal income tax reporting. DCT programs that combine federal, state, local, and private funds will need to decipher the appropriate tax treatment. Based on the detached, disinterested generosity standard, the source of funds—specifically, money that is pooled or combined from a variety of sources—should not affect the tax treatment of DCTs, as long as the payments are distributed out of detached, disinterested generosity and not as disguised compensation. Again, if the source of DCT funds exclusively consist of COVID-19 relief dollars, or other expressly exempted funds, based on official guidance, recipients can take possession of the funds with no federal personal income tax consequences.

- The intent behind the payment. In order to qualify for exemption from recognition as income, the intent behind the DCT is crucial. DCT programs should ensure the transfer of DCT funds are structured without a quid pro quo. The intent, terms, and conditions behind a DCT payment should make clear no services were rendered in exchange for transfer of the DCT funds to recipients. Adoption fees, disaster relief, and private donations through cash gifts and crowdfunding platforms are important examples of payments excluded from income when the intent is charitable. DCT payments should have no strings attached, including no services performed by recipients in exchange for the DCT funds.

- Financial need of recipients. Existing exclusions of income for public and social benefits and emergency rental assistance are provided to "promote the general welfare" of individuals and families. DCTs structured to promote the general welfare of individuals and families are more likely to be excluded as income.

[19] "The first $10,000 of such gifts. . . shall not. . . be included in the total amount of gifts made during such year."

OTHER CONSIDERATIONS AROUND DCTS AND RECIPIENT PARTICIPATION IN EVALUATIONS

It is important to distinguish between DCT payments and payments made for participation in research studies. If DCT payments are associated with direct participation in research studies, or social science evaluation programs, participation in the research could arguably be classified as a *quid pro quo* for DCTs. However, states like Illinois have proactively exempted research study payments from recognition as income for public benefit purposes, but have not addressed the relevant tax treatment of these payments (Illinois Public Aid Code, 2019). Otherwise, a pilot study approach and a full-fledged research program would be treated the same, with neither scenario altering the *quid pro quo* requirement, particularly if substantial amounts of DCT funds were tied directly to participation in the research. Conversely, *de minimis* study stipends, separate from DCT funds, would likely escape scrutiny, so long as the payments are modest and not otherwise be determined to be "disguised wages" (Internal Revenue Service, 2022c). [20]

Importantly, direct tax guidance from federal and state legislatures would benefit program recipients, funders, and program administrators by expressly delineating specific parameters for exclusion from income. Presently, DCT program funders, administrators, and recipients are left to extrapolate from similar, existing codified exclusions from income. While there are other instances where existing exclusions from income are either presumed, or informal but not codified, express guidance would provide greater certainty (Kratzke, 2022).[21]

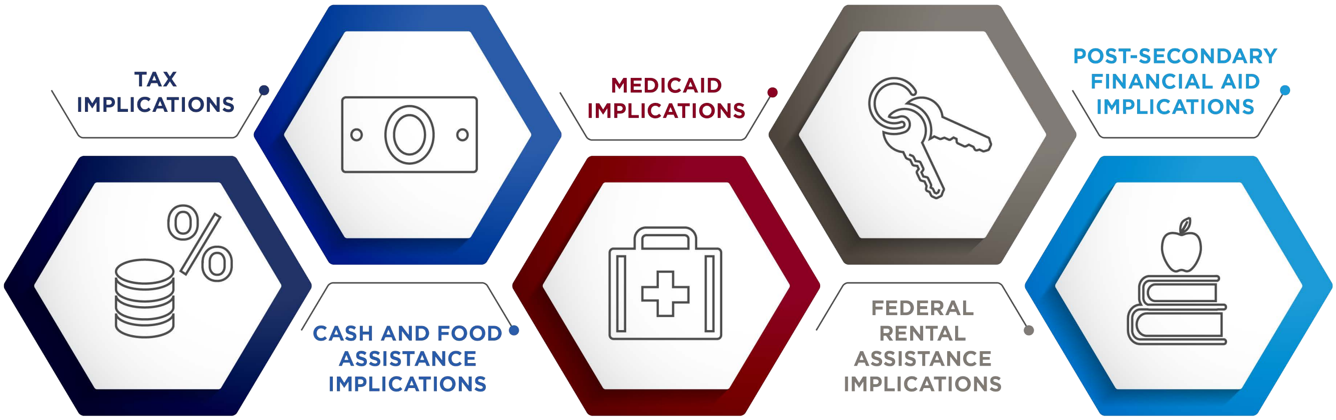
CONCLUSION

This white paper examined the potential tax implications of direct cash transfers (DCTs), funds intended to provide short-term assistance and cover basic expenses, specifically paid to families and youth experiencing homelessness. The paper emphasizes the lack of specific guidance regarding the tax treatment of direct cash transfers. Legislative and official guidance from the Internal Revenue Service, U.S. Treasury Department, and state and local revenue agencies is vital to address this information gap. Absent legislative or official revenue agency fiat expressly excluding DCTs from gross income, program administrators and DCT recipients should seek appropriate case-by-case guidance to ensure they are complying with all applicable federal and state income tax reporting requirements.

[20] Case by case analyses provide greater certainty since facts can alter the tax repercussions. For example "[a]mount received by taxpayer for participating in gout study was not excluded from his gross income under 26 USCS § 104(a)(2), as he did not allege that he suffered from physical injury or sickness on account of study or prove direct causal link between payment and gout he had suffered from for 25 years." O'Connor v. Comm'r, 104 T.C.M. (CCH) 571, T.C. Memo 2012-317, 104 T.C.M. (CCH) 571, 2012 Tax Ct. Memo LEXIS 318 (T.C. Nov. 14, 2012), aff'd, , 2015-2 U.S. Tax Cas. (CCH) ¶ 0364, 606 Fed. Appx. 390, 115 A.F.T.R.2d (RIA) 2015-2300, 2015-2 U.S. Tax Cas. (CCH) P50364, 2015 U.S. App. LEXIS 11241 (9th Cir. 2015)

[21] "Incidentally, the Code nowhere states that loan proceeds are not included in a taxpayer's gross income, but we all understand that to be the rule."

The toolkit is comprised of well-researched, vetted, and user-friendly resources providing clear policy analyses and recommendations to help state and local jurisdictions develop and evaluate direct cash transfer (DCT) projects for youth and young adults in ways that maximize their positive outcomes while minimizing risks to participants.



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Recommended Citation

Laínez Flanagan, J. (2022). *Direct cash transfers and tax policy: Reporting cash transfers for the maximum benefit to the recipients.* Chicago, IL: Chapin Hall at the University of Chicago.

Disclaimer

The opinions expressed are solely those of the author and do not necessarily reflect the official position of funders. Nothing in this work should be construed as legal advice. This work would not be possible without the generous support of the Annie E. Casey Foundation. We offer thanks to the numerous individuals who contributed their lived and subject matter expertise, review, and input, which were critical to shaping this product, including: Amy Matsui, National Women's Law Center; Elaine Maag, Tax Policy Center, Urban Institute; William Kratzke, University of Memphis, Cecil C. Humphreys School of Law; Emely Hernandez, Chapin Hall.