

A TAX FRAMEWORK FOR CROWDFUNDING IN SOUTH AFRICA

by

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ABSTRACT

A TAX FRAMEWORK FOR CROWDFUNDING IN SOUTH AFRICA

Crowdfunding is an innovative tool used by entrepreneurs and small businesses to access capital from sources other than the financial services and the banking industry. It is one of the most promising tools to assist in enabling economic growth, job creation and innovation by supplying capital to entrepreneurs and small businesses. Crowdfunding refers to a method of raising funds by using social media and social networks. The main crowdfunding models identified (classified on the basis of the type of return received in exchange for the funds provided) are: the donation model, the rewards model, the debt model and the equity model. Since there are currently no specific tax legislation provisions in South Africa for crowdfunding transactions, the tax implications of crowdfunding transactions fall within the general tax principles of the Income Tax Act. The tax treatment of crowdfunding models is not always certain. The main purpose of this study is to determine whether specific legislation or amendments to existing provisions are required for crowdfunding transactions or whether the existing provisions are sufficient in South Africa. The main focus is from a tax perspective but other relevant existing legislative requirements such as the Companies Act that have an influence on tax legislation, have also been considered. An exploratory mixed method approach was followed by conducting a literature study, conducting interviews and also obtaining results from a survey instrument. This study aims to assist in developing and establishing a distinct framework for the South African crowdfunding industry. It is proposed that a single tax credit should be introduced for funders to accommodate crowdfunding performed in support of small businesses.

Keywords: Crowdfunding, debt-based crowdfunding, donor-based crowdfunding, entrepreneurship, equity-based crowdfunding, income tax, rewards-based crowdfunding, small business funding, tax credit, tax incentive.

OPSOMMING

'N BELASTINGRAAMWERK VIR SKAREFINANSIERING IN SUID-AFRIKA

Skarefinansiering is 'n innoverende hulpmiddel wat deur entrepreneurs en klein ondernemings gebruik word om kapitaal van bronne anders as finansiële dienste en die bankbedryf te verkry. Dit is een van die belowendste hulpmiddels om ekonomiese groei, werkskepping en innovering moontlik te maak deur kapitaal aan entrepreneurs en klein ondernemings te voorsien. Skarefinansiering verwys na 'n metode om fondse in te samel deur van sosiale media en sosiale netwerke gebruik te maak. Die hoofmodelle van skarefinansiering wat geïdentifiseer is (geklassifiseer op grond van die soort opbrengs wat ontvang word in ruil vir die fondse wat voorsien word) is die skenkingsmodel, die vergoedingsmodel, die skuldmodel en die ekwiteitsmodel. Aangesien daar in Suid-Afrika tans geen spesifieke voorsiening in belastingwetgewing vir skarefinansieringstransaksies gemaak word nie, sorteer die implikasies van skarefinansieringstransaksies binne die algemene belastingbeginsels van die Inkomstebelastingwet. Die hantering van belasting van skarefinansieringsmodelle is nie altyd seker nie. Die hoofdoel van hierdie studie was om te bepaal of spesifieke wetgewing of wysigings aan bestaande bepalings vir skarefinansieringstransaksies vereis word en of die bestaande bepalings in Suid-Afrika voldoende is. Die hooffokus is vanuit 'n belastingperspektief, maar ander toepaslike bestaande wetlike vereistes, soos die Maatskappywet wat 'n invloed op belastingwetgewing het, is ook in ag geneem. 'n Ondersoekende gemengde metode benadering is gevolg deur 'n literatuurstudie en onderhoude te onderneem, asook deur resultate vanaf 'n opname-instrument te verkry. Die mikpunt van die studie was om ondersteuning te verleen aan die ontwikkeling en vestiging van 'n duidelike raamwerk vir die Suid-Afrikaanse skarefinansieringsbedryf. Daar word voorgestel dat 'n enkele belastingkrediet vir befonders ingestel word om skarefinansiering te akkommodeer wat onderneem word om klein ondernemings te ondersteun.

Sleutelwoorde: Skarefinansiering, skuldgebaseerde skarefinansiering, skenkergebaseerde skarefinansiering, entrepreneurskap, ekwiteitsgebaseerde

skarefinansiering, inkomstebelasting, vergoedinggebaseerde skarefinansiering, klein ondernemingbefondsing, belastingkrediet, belastinginsentief.

OKUCASHUNIWE

UHLAKA LWENTELA LOKUQONGELELA IMALI ENANINI ELIKHULU LABANTU LAPHO EMUNYE ENIKELA NGEMALI ENCANE, NGOKWEJWAYELEKILE NGE-INTHANETHI ENINGIZIMU AFRIKA

Ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi yithuluzi elisha elisetshenziswa ngabantu abasungula amabhizinisi, bethatha ubungozi bezezimali ngethemba lenzuzo kanye namabhizinisi amancane ukuthola imali evela kweminye imithombo ngaphandle kwezinsizakalo zezezimali kanye nemboni yasebhangwe. Kungelinye lamathuluzi athembisa kakhulu ukunika amandla ekukhuliseni komnotho, ukuvulwa kwamathuba emisebenzi kanye nokusungula izinto ezintsha ngokunikezela ngemali ebantwini abasungula amabhizinisi, bethatha ubungozi bezezimali ngethemba lenzuzo kanye namabhizinisi amancane. Ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi kubhekisa endleleni yokuqongelela imali ngokusebenzisa imithombo yezokuxhumana kanye nokusetshenziswa kwezingosi zokuxhumana ezisuselwa ku-inthanethi ukuze uhlale uxhumekile nabantu. Izifanekiso eziyinhloko zokuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi ezihlonziwe (ezihlukaniswe ngesisekelo sohlobo lwenzuzo etholakele kushintshaniswa nezimali ezinikeziwe) yizifanekiso zomnikelo, isifanekiso semiklomelo, isifanekiso sesikweletu kanye nesifanekiso sokulingana. Njengoba njengamanje kungekho zinhlinzeko ezithile zomthetho wentela eNingizimu Afrika zokuthengiselana kwemali eqongelelwe enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi, imiphumela yentela yokuthengiselana kwemali eqongelelwe enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi, iwela ngaphansi kwemigomo yentela jikelele Yomthetho Wentela Yemali Engenayo. Ukuphathwa kwentela yezifanekiso zokuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi akuhlali kuqinisekile ngaso sonke isikhathi. Inhloso enkulu yalolu cwaningo bekungukuthola ukuthi ngabe umthetho othile noma izichibiyelo ezihlinzekiwe ezikhona ziyadingeka yini ekuqongeleleni imali enanini elikhulu labantu

lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi noma ngabe amalungiselelo akhona anele yini eNingizimu Afrika. Ukugxila okuyinhloko kususelwa embonweni wentela kodwa ezinye izidingo ezifanele zomthetho ezifana noMthetho Wezinkampani onomthelela emithethweni yentela nazo zibhekiwe. Indlela ehlangene yokuhlola ilandelwe ngokwenza ucwaningo lwezincwadi kanye nezingxoxo kanye nokuthola imiphumela ethuluzini lokuhlola. Lolu cwaningo luhlose ukusiza ekwakheni nasekusunguleni uhlaka olwehlukile lomkhakha wezimboni zaseNingizimu Afrika zokuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi. Kuphakanyiswa ukuthi kwethulwe isikweletu esisodwa sentela kubaxhasi bezimali ukubhekela ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi kwenziwe ukuxhasa osomabhizinisi abancane.

Amagama asemqoka:

Crowdfunding

ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi

debt-based crowdfunding

ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi okususelwa esikweletini

donor-based crowdfunding

ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi okususelwa konikelayo

entrepreneurship

isenzo sokusungula ibhizinisi, uthatha ubungozi bezezimali ngethemba lenzuzo

equity-based crowdfunding

ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi okususelwa ekulinganeni

income tax

intela yemali engenayo

rewards-based crowdfunding

ukuqongelela imali enanini elikhulu labantu lapho emunye enikela ngemali encane, ngokwejwayelekile nge-inthanethi okususelwa emiklomelweni

small business funding

uxhaso lwamabhizinisi amancane

tax credit

isikweletu sentela

tax incentive

isikhuthazo sentela

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION AND BACKGROUND	1
1.1 A BRIEF HISTORY OF CROWDFUNDING.....	1
1.2 CROWDFUNDING	6
1.2.1 Defining crowdfunding	6
1.2.2 The components of crowdfunding	8
1.3 RATIONALE FOR THIS STUDY	11
1.4 RESEARCH PROBLEM	13
1.5 RESEARCH OBJECTIVES	13
1.5.1 Main objective	13
1.5.2 Secondary objectives	14
1.6 RESEARCH QUESTIONS.....	14
1.7 DELINEATION AND LIMITATIONS.....	15
1.8 UNDERLYING ASSUMPTIONS	15
1.9 SUMMARY AND STRUCTURE.....	16
CHAPTER 2: CROWDFUNDING BACKGROUND AND OVERVIEW	19
2.1 INTRODUCTION	19
2.2 DIFFERENT MODELS OF CROWDFUNDING	19
2.2.1 Donation model	20
2.2.2 Rewards model	23
2.2.3 Debt model	29
2.2.4 Equity model.....	30
2.2.5 Other models.....	31
2.3 BEHAVIOUR OF FUNDERS	31
2.4 REASONS FOR USING CROWDFUNDING.....	33
2.4.1 Access to financing	33

2.4.2	Stimulation of the economy	36
2.4.3	Market testing and validation of products or services	37
2.4.4	Brainstorming	37
2.4.5	Developing a market early in the start-up process	37
2.4.6	Intrinsic motivations	38
2.5	RISKS OF USING CROWDFUNDING	38
2.5.1	Losses suffered by investors	39
2.5.2	Fraud	39
2.5.3	Failure to achieve production timetables and delivery promises	41
2.5.4	Money laundering	42
2.5.5	Investor protection	42
2.5.6	Intellectual property protection	43
2.5.7	Tax evasion	44
2.6	CONCLUSION.....	44
CHAPTER 3: RESEARCH PHILOSOPHY AND RESEARCH DESIGN.....		46
3.1	INTRODUCTION	46
3.2	RESEARCH PHILOSOPHY AND RESEARCH METHODOLOGY	46
3.3	RESEARCH DESIGN	48
3.3.1	Qualitative first phase of the research design.....	51
3.3.2	Quantitative second phase of the research design.....	52
3.3.3	Measuring instruments	53
3.3.4	Statistical analysis	54
3.3.5	Ethical considerations	55
3.4	CONCLUSION.....	55
CHAPTER 4: INTERNATIONAL DEVELOPMENTS OF CROWDFUNDING.....		56
4.1	INTRODUCTION	56
4.2	DONATION AND REWARDS MODELS.....	58
4.2.1	United States of America.....	58
4.2.2	United Kingdom.....	63

4.2.3	Australia	67
4.2.4	New Zealand	70
4.3	DEBT MODEL	72
4.3.1	United States of America.....	72
4.3.2	United Kingdom.....	72
4.3.3	Australia	74
4.3.4	New Zealand	74
4.4	EQUITY MODEL	74
4.4.1	United States of America.....	75
4.4.2	United Kingdom.....	81
4.4.3	Australia	92
4.4.4	New Zealand	94
4.5	CONCLUSION.....	98
CHAPTER 5: POLICY CONSIDERATIONS UNDERPINNING CROWDFUNDING IN SOUTH AFRICA..... 112		
5.1	INTRODUCTION	112
5.2	THE NATIONAL DEVELOPMENT PLAN VISION FOR 2030.....	112
5.3	THE WORLD BANK'S REPORT: SOUTH AFRICA'S COUNTRY-LEVEL FISCAL POLICY NOTES: SECTOR STUDY OF EFFECTIVE TAX BURDEN AND EFFECTIVENESS OF INVESTMENT INCENTIVES IN SOUTH AFRICA – PART I.....	114
5.4	THE DAVIS TAX COMMITTEE'S REPORT: MACRO ANALYSIS OF THE TAX SYSTEM AND INCLUSIVE GROWTH IN SOUTH AFRICA.....	115
5.5	THE MIRRLEES COMMISSION.....	116
5.6	THE ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD).....	118
5.7	CONCLUSION.....	119

CHAPTER 6: AN EVALUATION OF THE CURRENT INCOME TAX PROVISIONS IN SOUTH AFRICA.....	123
6.1 INTRODUCTION	123
6.2 EXISTING INCOME TAX PROVISIONS APPLICABLE TO INVESTMENT IN SMALL BUSINESSES	123
6.2.1 Small business funding entities	125
6.2.2 Small business undertakings.....	127
6.2.3 Venture capital companies	127
6.2.4 Small business corporations.....	130
6.3 EXISTING INCOME TAX ACT PROVISIONS ADDRESSING CROWDFUNDING	131
6.3.1 Donation and rewards model.....	132
6.3.2 Debt model.....	151
6.3.3 Equity model.....	157
6.3.4 The crowdfunding platform	170
6.4 CONCLUSION.....	171
CHAPTER 7: RESULTS FROM THE INTERVIEWS	175
7.1 INTRODUCTION	175
7.2 RESULTS.....	176
7.2.1 What are the different crowdfunding models? (Addressing research question 1).....	176
7.2.2 What are the reasons and background for using crowdfunding? (Addressing research question 2).....	186
7.2.3 What are the tax implications of the different crowdfunding models currently in South Africa? (Addressing research question 4).....	187
7.3 CONCLUSIONS FROM INTERVIEWS CONDUCTED.....	188
CHAPTER 8: EMPIRICAL RESULTS.....	192
8.1 INTRODUCTION	192
8.2 DEVELOPMENT AND IMPLEMENTATION OF THE QUESTIONNAIRE	192

8.3	COMPLETION OF THE QUESTIONNAIRE	192
8.4	LIMITATIONS AND PRACTICAL PROBLEMS REGARDING THE EMPIRICAL STUDY	193
8.5	DEMOGRAPHICS OF RESPONDENTS	194
8.5.1	Gender of respondents.....	194
8.5.2	Age group of respondents	194
8.5.3	Race of respondents	195
8.5.4	Province where currently located	196
8.5.5	Main field in which occupied.....	196
8.5.6	Level of financial literacy	197
8.5.7	Link to the questionnaire	198
8.6	RESPONDENTS' KNOWLEDGE OF CROWDFUNDING MODELS	199
8.6.1	Source of knowledge of crowdfunding.....	199
8.6.2	Familiarity with crowdfunding models.....	199
8.6.3	Participation in crowdfunding projects	200
8.6.4	Purpose of crowdfunding.....	201
8.6.5	Access to capital	201
8.6.6	Risks associated with investment.....	203
8.6.7	Knowledge of taxation	204
8.6.8	Effect of incentives	206
8.7	CONCLUSIONS FROM THE SURVEY INSTRUMENT	214
CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS OF THE STUDY AND RECOMMENDATIONS FOR FURTHER RESEARCH.....		221
9.1	INTRODUCTION	221
9.2	PROBLEM STATEMENT, RESEARCH QUESTIONS AND RESEARCH OBJECTIVES	222
9.3	A REVIEW OF THE RESEARCH RESULTS.....	223
9.3.1	Conclusions from Chapter 2.....	223
9.3.2	Conclusions from Chapter 3	224

9.3.3	Conclusions from Chapter 4	224
9.3.4	Conclusions from Chapter 5	225
9.3.5	Conclusions from Chapter 6	225
9.3.6	Summary of the results of the interviews in Chapter 7	226
9.3.7	Summary of the empirical results in Chapter 8	227
9.4	A TAX FRAMEWORK FOR CROWDFUNDING IN SOUTH AFRICA.....	228
9.4.1	Define crowdfunding.....	229
9.4.2	Regulate crowdfunding.....	230
9.4.3	Tax guidance on what constitutes a donation.....	234
9.4.4	Tax guidance on what constitutes a trade	237
9.4.5	Specific tax incentives	237
9.5	SIGNIFICANCE OF THE STUDY	250
9.6	FUTURE RESEARCH	250
9.7	CONCLUDING REMARKS.....	251
	LIST OF REFERENCES.....	252
	ANNEXURE A	275
	ANNEXURE B	277
	ANNEXURE C	286

LIST OF TABLES

Table 1: World Internet usage and population statistics	4
Table 2: Summary of platform data as at 21 April 2020	21
Table 3: Summary of platform data as at 6 April 2018	22
Table 4: Comparison between Jumpstarter, Thundafund and Kickstarter	25
Table 5: Protective measures against potential fraud	40
Table 6: Comparison of four research philosophies in management research	47
Table 7: Comparison of EIS and SEIS relief provisions	86
Table 8: Equity crowdfunding regulation comparison	97
Table 9: Tax incentives comparison	100
Table 10: Equity crowdfunding regulation	110
Table 11: Summary of policy considerations	121
Table 12: Comparison of the definition of securities	152
Table 13: Comparison of the definition of a share	154
Table 14: Crowdfunding model that the platform supports.....	176
Table 15: Reason for support of the crowdfunding model of the platform.....	178
Table 16: Date from which platform has been active	180
Table 17: Residency of project creators who use the platform	181
Table 18: Residency of funders who use the platform	181
Table 19: Platform statistics.....	193
Table 20: Gender of respondents	194
Table 21: Age group of respondents.....	195
Table 22: Race of respondents.....	196
Table 23: Location of respondents.....	196
Table 24: Field of occupation of respondents	197
Table 25: Level of financial literacy of respondents	198

Table 26 : Source of link to the questionnaire	198
Table 27: Source of knowledge of crowdfunding	199
Table 28: Crowdfunding models familiar with	200
Table 29: Contributed to a crowdfunded project	200
Table 30: Created a crowdfunded project to obtain funding.....	200
Table 31: Will make use of crowdfunding to obtain funding.....	201
Table 32: Purpose of crowdfunding	201
Table 33: Should investment opportunities be available to everybody?	202
Table 34: Should only banks provide funding?	203
Table 35: Ease of access to funds by entrepreneurs	203
Table 36: Likelihood of perceived risk of all respondents.....	204
Table 37: Likelihood of risk of only those who had participated in a project.....	204
Table 38: Knowledge of SA ITA.....	205
Table 39: Familiarity of respondents with income tax consequences of the funder	205
Table 40: Encouragement of tax legislation in support of crowdfunding	205
Table 41: Should crowdfunding be taxed?	206
Table 42: Influence of a possible tax deduction for all respondents.....	207
Table 43: Effect of a tax deduction in relation to a random project	207
Table 44: Effect of a tax deduction in relation to only those who contributed.....	207
Table 45: Effect of a tax deduction on a random project, related to only those who had previously contributed to a project	208
Table 46: Factors that encouraged respondents to invest (those who had invested)	209
Table 47: Expected benefit (those who invested)	210
Table 48: Factors that would encourage participants to invest (those who had contributed)	211
Table 49: Factors that would encourage participants to invest	212
Table 50: Comparative summary: Different models of crowdfunding.....	215
Table 51: Comparative summary: Behaviour of funders	215

Table 52: Comparative summary: Reasons for using crowdfunding217

Table 53: Comparative summary: Risks of using crowdfunding218

Table 54: Comparison of policy considerations with recommendations.....247

LIST OF FIGURES

Figure 1: Crowdfunding participants	8
Figure 2: Typical crowdfunding process.....	10
Figure 3: Crowdfunding adoption curve	34
Figure 4: The amount of capital grows with the social network	35
Figure 5: Suitability of crowdfunding models for the developing world	36
Figure 6: Three basic mixed method designs	50
Figure 7: Government, NGO and private sector recommendations	56
Figure 8: The missing middle	124
Figure 9: Determination of the crowdfunding model for Income Tax purposes	236
Figure 10: Donation model income tax implications	240
Figure 11: Rewards model income tax implications	242
Figure 12: Debt model income tax implications.....	244
Figure 13: Equity model income tax implications	246

LIST OF ABBREVIATIONS

Abbreviation	Meaning
ASIC	Australian Securities and Investment Commission
ATO	Australian Tax Office
B-BBEE	Broad-Based Black Economic Empowerment
CAMAC	Corporations and Markets Advisory Committee
CGT	Capital gains tax
CIPC	Companies and Intellectual Property Commission
COBS	Conduct of Business sourcebook
EIS	Enterprise Investment Scheme
ESIC	Early Stage Innovation Companies
FSB	Financial Service Board
FSCA	Financial Sector Conduct Authority
FSMA	Financial Services and Markets Act 2000
HMRC	Her Majesty's Revenue and Customs
IR	Inland Revenue
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISA	Individual Savings Account
ITAA97	Income Tax Assessment Act 1997
ITA	Income Tax Act of South Africa No. 58 of 1962
NDP	National Development Plan
NGO	Non-governmental Organisation
NPC	Non-profit Company
NPO	Non-profit Organisation
NZ	New Zealand
OECD	Organisation for Economic Cooperation and Development
PBO	Public Benefit Organisation
SA	South Africa
SARS	South African Revenue Service
SBFE	Small Business Funding Entity
SEC	Securities and Exchange Commission
SEIS	Seed Enterprise Investment Scheme
SITR	Social Investment Tax Relief
SMEs	Small and medium enterprises

Abbreviation	Meaning
UK	United Kingdom
USA	United States of America
VCC	Venture Capital Company

CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1 A BRIEF HISTORY OF CROWDFUNDING

The small and medium-size business sector is critical for addressing unemployment and growth of the economy in South Africa (Fatoki, 2014a:922). This is also recognised in South Africa's National Development Plan (NDP) where it is stated that, "Small and expanding firms will become more prominent, and generate the majority of new jobs created. They will also contribute to changing apartheid legacy patterns of business ownership" (South Africa. National Planning Commission, 2011:117). Access to funding is one of the main obstacles that constraints the growth of the small and medium-sized business sector (Cosh, Cumming & Hughes, 2009:1530-1531; Shadrach-Razzino, Chetty & Pick, 2017; Bradford, 2012:5). The difficulty in attracting outside capital is mainly due to a lack of collateral and the information asymmetry faced by investors regarding the fund-seeking firm's quality (Cosh *et al.*, 2009:1494-1497; Lee, Sameen & Cowling, 2015:370).

The 2008 financial crisis, which was initially limited to the Northern American sub-prime mortgage sector, had an effect on economies globally and resulted in a lack of trust in the financial services and the banking industry (Lee *et al.*, 2015:370). Access to credit granted by financial institutions was severely restricted after 2008, leaving numerous small businesses and entrepreneurs without funding (De Buysere, Gajda, Kleverlaan, Marom & Klaes, 2012:8; Lee *et al.*, 2015:370).

In order to assist small and medium-sized enterprises (SMEs) to obtain funding and to become sustainable businesses, the South African government aims to improve access to debt and equity finance and to simplify the regulatory environment for small and medium-sized businesses (South Africa. National Planning Commission, 2011:93,117; South African Government, 2016:23). Based on the goals of the Government, as contained in the NDP, and the reluctance of financial institutions to serve SMEs, alternative methods of raising capital need to be explored. There is therefore a policy imperative to encourage alternative, innovative funding options for SMEs in South Africa.

Albert Einstein once said, “we cannot solve our problems with the same thinking we used when we created them” (Albert Einstein Quotes, n.d.). Funding is normally derived from traditional sources of funding such as venture capital, the financial services and the banking industry, which are now, after the 2008 financial crisis, even more reluctant to provide funding to upcoming businesses. Crowdfunding is an innovative tool used by entrepreneurs and small businesses to access capital from sources other than traditional sources (Mollick, 2014:2). It became a more prominent means of obtaining funding by early-stage small businesses after the 2008 financial crisis (World Bank, 2013:14).

Crowdfunding is one of the most promising tools to assist in enabling economic growth, job creation and innovation by supplying capital to entrepreneurs and small businesses (De Buysere *et al.*, 2012:8). Through crowdfunding, funding is obtained from a large number of investors. It is a method of raising funds by using social media and social networks and consists of the following components:(1) many investors; (2) each investor provides a relatively small amount of money; and (3) the use of the Internet that connect individuals across the globe (Pekmezovic & Walker, 2016:358).

Gustave Le Bon (1896:xiv-xv) stated in 1896 in the introduction of his book called “The Crowd: A Study of the Popular Mind” that:

...[w]hile all our ancient beliefs are tottering and disappearing, while the old pillars of society are giving way one by one, the power of the crowd is the only force that nothing menaces, and of which the prestige is continually on the increase. The age we are about to enter will in truth be the era of crowds. (Le Bon, 1896:xiv-xv)

Crowdfunding makes use of the power of the crowd (a large number of investors) and has the potential to democratise access to investment opportunities since investment opportunities are no longer restricted to only accredited investors (Pekmezovic & Walker, 2016:351-352). Crowdfunding might therefore also be a valuable tool in changing the apartheid legacy patterns of business ownership, where ownership of businesses was

mostly restricted to a few wealthy individuals who could provide collateral to the financial institutions and financiers.

According to Lee, DeWester and Park (2008:336), the Web 2.0 era provides significant opportunities for small businesses, allowing them to have, *inter alia*, the same reach as large businesses through the respective websites of the businesses. The Web 2.0 is defined as “a collective term for certain applications of the Internet and the World Wide Web, including blogs, wikis, video sharing services, and social media websites such as Facebook and MySpace, which focus on interactive sharing and participatory collaboration rather than simple content delivery” (BusinessDictionary.com, n.d.).

Crowdfunding became an even more popular method of obtaining funds with the commercialisation of the Internet (World Bank, 2013:17). This is because the use of the Internet resulted in the matching of funders with project creators in a more efficient and effective manner due to lower online search cost. The importance of crowdfunding as a means of mobilising resources was highlighted in a discussion amongst a group of experts about the current state of crowdfunding, its future and emerging trends (Assenova *et al.*, 2016:25). Ron Suber, the president of Prosper Marketplace, America’s first peer-to-peer lending marketplace, stated that:

...for the first time in history, we’re seeing a collision between Wall Street and Silicon Valley and the banking industry, and this is driven by the Gen X, Gen Y, and Millennials’ need to do things in a different way. They’re used to sharing so much on the Internet, and now they want to borrow and lend on the Internet. I think it’s a trend that’s irreversible. These young people aren’t going back to the old way, the way their parents moved money and paid for things and borrowed and lent.

(Assenova *et al.*, 2016:34-35)

The number of individuals around the world with Internet access is estimated at 4.4 billion (3.6 billion when the source was accessed in 2016), representing almost 60% of the world’s population (see Table 1 below).

Table 1: World Internet usage and population statistics (World Internet Users Statistics and World Population Stats, n.d.)

WORLD INTERNET USAGE AND POPULATION STATISTICS JUNE, 2019 – Updated						
World regions	Population (2019 Est.)	Population % of world	Internet users 30 June 2019	Penetration rate (% Pop.)	Growth 2000-2019	Internet world %
Africa	1,320,038,716	17.1 %	525,148,631	39.8 %	11,533 %	11.9 %
Asia	4,241,972,790	55.0 %	2,200,658,148	51.9 %	1,825 %	49.8 %
Europe	829,173,007	10.7 %	719,413,014	86.8 %	585 %	16.3 %
Latin America / Caribbean	658,345,826	8.5 %	447,495,130	68.0 %	2,377 %	10.1 %
Middle East	258,356,867	3.3 %	173,576,793	67.2 %	5,184 %	3.9 %
North America	366,496,802	4.7 %	327,568,628	89.4 %	203 %	7.4 %
Oceania / Australia	41,839,201	0.5 %	28,634,278	68.4 %	276 %	0.6 %
WORLD TOTAL	7,716,223,209	100.0 %	4,422,494,622	57.3 %	1,125 %	100.0 %

Internet user growth has expanded by 1 125% between 2000 and 2019. Of Africa’s population indicated in Table 1, South Africa’s estimated population is 58 065 097 (54 300 704 in 2016) and the number of Internet users in South Africa is estimated at 32 615 165 (28 580 290 in 2016). This represents approximately 56% of the population of South Africa. Since the number of Internet users in South Africa was estimated at only 2 400 000 in 2000 in comparison with 32 615 165 in 2019, it is clear that the number of Internet users is increasing rapidly every year (World Internet Users Statistics and 2016 World Population Stats, n.d.). Although it cannot be assumed or concluded from Table 1 above that all Internet users have the capital to contribute nor that, if they have, they will contribute to a crowdfunding project, it cannot be ignored that the potential exists for Internet users to contribute to an entrepreneurial investment somewhere across the globe.

Crowdfunding is used for a variety of fund-raising purposes but has developed mainly in the industries of arts and creativity such as the recorded music, film and video games industries (Agrawal, Catalini & Goldfarb, 2013:3). In South Africa, a well-known South African singer used a crowdfunding platform, named Jumpstarter, to obtain funding for a new compact disc that he wished to release (Venter, 2016:11). On 11 August 2016, with 21 days to go, the singer had already received R161 200 (161% of his goal of R100 000) from a total of 77 funders from this crowdfunding project (Jumpstarter Crowdfunding South Africa, n.d.). On another crowdfunding platform, Thundafund, a South African band raised R1 082 300 from 1 528 funders, far more than their initial goal amount of R500 000, while

another South African singer raised R223 152, also exceeding his initial goal amount of R200 000 (Thundafund.com, n.d.). Not all fund-raising is done in the arts and creativity field: President Barack Obama, for example, raised approximately \$750 million from crowdfunding donors to support his pre-election campaign (Bradley, 2008:1). These findings were observed in the initial phases of this study and ever since, numerous other examples have been available.

Students can register on the Feenix crowdfunding platform to raise money to pay their education fees. The platform trades in a trust, The Feenix™ Trust, which is a registered public benefit organisation that is administered by Standard Bank. Donors can donate money either to an individual student or to a pool of funds, and will receive a tax deduction for the contribution made in terms of section 18A of the Income Tax Act of South Africa No. 58 of 1962 (ITA) (South Africa, 1962). Feenix withholds 5% of the amount received from the funder for the costs of administering the Feenix™ Trust and pays the balance directly to the educational institution where the student is enrolled. The contribution can also count towards the funder's B-BBEE status. As at 6 May 2019, the Feenix platform had 1 201 registered funders, 860 students received funding and R24.75 million had been raised to date (Feenix, n.d.). These figures increased to R47.4 million for 1 309 students by 19 October 2020 (Feenix, n.d.). These few examples of crowdfunding indicate that crowdfunding is a popular means of accessing funds in South Africa.

One of the main challenges with crowdfunding is the compliance regime (Assenova *et al.*, 2016:33-34). The funders of crowdfunding projects are subject to an unusually high degree of risk due to the absence of strict governance, reporting, accounting and other requirements common in publicly traded securities markets (Agrawal *et al.*, 2013:7). Globally, attention has only been given in recent years to crowdfunding and the regulation thereof. The lack of policies and regulations relating to the taxation of crowdfunding on a global basis is evident from the following extracts from articles and papers:

As always appears to be the case, legislation is lagging behind what is occurring, or what is about to burst, onto the market. So is the case with taxation and crowdfunding. There is much commentary in this area at present but very little

gives any concrete answers. The main reason is due to the process of legislation playing catch-up. (Brandon, 2015:446)

Taxing crowdfunding pledges is one of a host of policy considerations that government agencies must address in coming months as the technique becomes increasingly popular and potentially hides questionable business dealings by both companies and investors. (Rudarakanchana, 2013)

The main problem affecting not only those involved in the transactions (e.g. funders, recipients of the funds and brokerage platforms), but also the tax authorities, is a lack of relevant experience. Yet taxation represents a not insignificant transaction cost, which must be reflected in business plans and financial planning. (Dietrich & Amrein, 2016:33)

One of the maxims of a good tax system, as laid down by Adam Smith (1776:639), is *certainty*. This determines that the tax that should be paid, should be certain and not arbitrary (Smith, 1776:639). As emphasised by the above extracts, there is no clarity or certainty globally on how some crowdfunding transactions should be taxed.

1.2 CROWDFUNDING

The term *crowdfunding* is central in this study. This section will define crowdfunding and highlight how some of its characteristics correspond with pre-existing concepts.

1.2.1 Defining crowdfunding

The concept of crowdfunding is founded in the concept of crowdsourcing (Belleflamme, Lambert & Schwienbacher, 2014:588). Luis, García and Estellés-Arolas (2015:132-133) classify crowdfunding as one of the five crowdsourcing models that they identified.

The concept of crowdsourcing was first mentioned by Jeff Howe and Mark Robinson in the June 2006 issue of an American magazine, *Wired* (Belleflamme *et al.*, 2014:4). Reference

is made by various researchers such as Fatoki (2014b:752), Schwienbacher and Larralde (2010:5) and Zhang (2012:10) to the following definition of crowdsourcing provided by Kleemann, Voß and Rieder (2008:6):

Crowdsourcing ... takes place when a profit oriented firm outsources specific tasks essential for the making or sale of its product to the general public (the crowd) in the form of an open call over the Internet, with the intention of animating individuals to make a contribution to the firm's production process for free or for significantly less than that contribution is worth to the firm.

According to Howe (2009:8,11), although crowdsourcing originated from the open-source movement in software, it is not at its essence about technology. More important is the human behaviour that technology engenders through the potential of the Internet (Howe, 2009:11). Howe (2009:8) submits that “the best person to do the job, is the one that wants the job”. Crowdsourcing strips away all considerations other than quality, such as pedigree, race, age and qualification (Howe, 2009:13). In addition, Howe contends that each person possesses a more complex range of talents than what they currently express in the economic structures, and that crowdsourcing unleashes that potential (Howe, 2009:13-14).

The definition of crowdsourcing by Kleemann *et al.* (2008:6) was extended by Belleflamme *et al.* (2014:588) to provide the following definition of crowdfunding: “Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or for some form of reward to support initiatives for specific purposes”.

This definition of crowdfunding is widely referred to and discussed in studies such as those of Gorshkov (2011:6), Belleflamme, Omrani and Peitz (2015:12), Heminway and Hoffman (2011:881), Mollick (2014:2), De Beer (2014:22) and Hemer (2011:8).

Mollick (2014:2) argues that the above definition of crowdfunding is too broad and suggests the following narrower definition by omitting the goal of the crowdfunding effort

and that of the investors from the above definition: “Crowdfunding refers to the efforts by entrepreneurial individuals and groups – cultural, social, and for-profit – to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the Internet, without standard financial intermediaries.” A limitation in this definition is the wording “without standard financial intermediaries”. It was determined that some platforms, such as ADDaBIT (a South African platform) uses an underwriter (Sanlam) which is a financial intermediary. Furthermore, it is possible for other financial institutions to contribute to a specific crowdfunding project. Although there are various other definitions of crowdfunding, the definition of Belleflamme *et al.* (2014:588) is therefore accepted for purposes of this study.

1.2.2 The components of crowdfunding

Crowdfunding makes use of the power of the crowd (a large number of investors) to obtain funding. It is a method of raising funds by using social media and social networks and consists of the following components: (1) many investors; (2) each investor provides a relatively small amount of money; and (3) the use of the Internet that connect individuals across the globe (Pekmezovic & Walker, 2016:358). The participants in a crowdfunding transaction are illustrated in Figure 1 below.

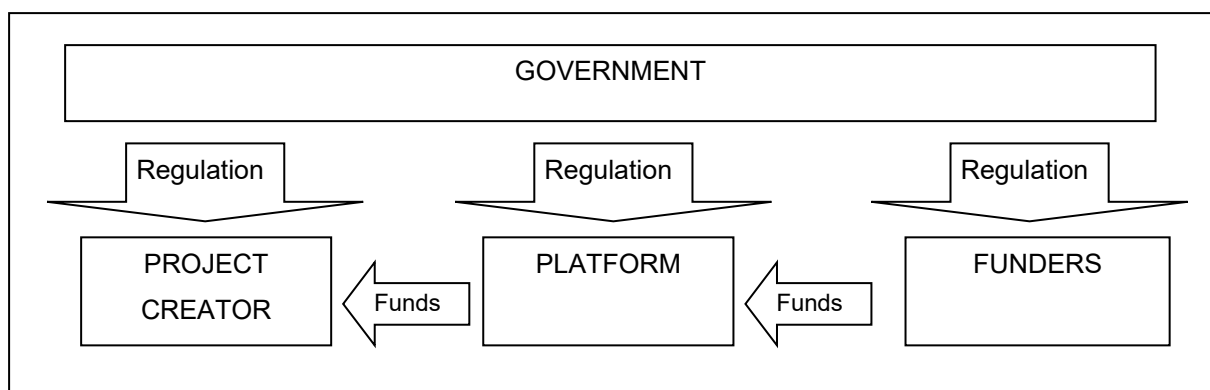


Figure 1: Crowdfunding participants (Own construct)

The four major participants of crowdfunding activities are the funders, creator of the project, the platform and the government that protects the general public and oversees the financial market operations (Li, Wang & Yue, 2015:3). “Project creator” refers to the

initiator of the project who requests funding for a particular project by indicating the purpose of the funding, the funding amount needed and the returns or rewards offered for the funders (Ordanini, Miceli, Pizzetti & Parasuraman, 2011:444; Li *et al.*, 2015:2). Project creators are also referred to as the creators, fund-seekers, entrepreneurs or borrowers, depending on the crowdfunding model used.

“Funders” refers to the investors providing funding for a project of the creator but also feedback or further participation (e.g. voting rights), depending on the crowdfunding model used (Dehling, 2013:9). They are also referred to as the funders, lenders or donors, depending on the crowdfunding model. Platforms tend to be Web- and software-based and facilitates the crowdfunding process as a neutral party between the project creator and the funders (Hemer, 2011:10). The crowdfunding platform is only present if the project creator uses a crowdfunding platform as an intermediary. The project creator can also elect not to make use of a crowdfunding platform and instead receive the donations/funding directly. However, the crowdfunding platform connects potential investors and entrepreneurs and facilitates the transfer of funds between the parties. The platform also facilitates the disclosure of information between the project creator and the funders.

The platform is not a bank or deposit taker and does not normally reinvest these funds further. The funds are held in escrow or trust accounts and not in the account of the platform (Pekmezovic & Walker, 2016:389). If the funding goal is reached, platforms normally require the project creator to pay a platform usage fee which is based on a percentage of the funds raised (Gerber & Hui, 2013:4). In addition, a payment processing fee is payable by the project creator to an established online payment processing system such as PayPal (Gerber & Hui, 2013:4). Crowdfunding referred to in this study refers to crowdfunding where the crowdfunding platform serves as the intermediary. A typical crowdfunding process may be illustrated as follows:

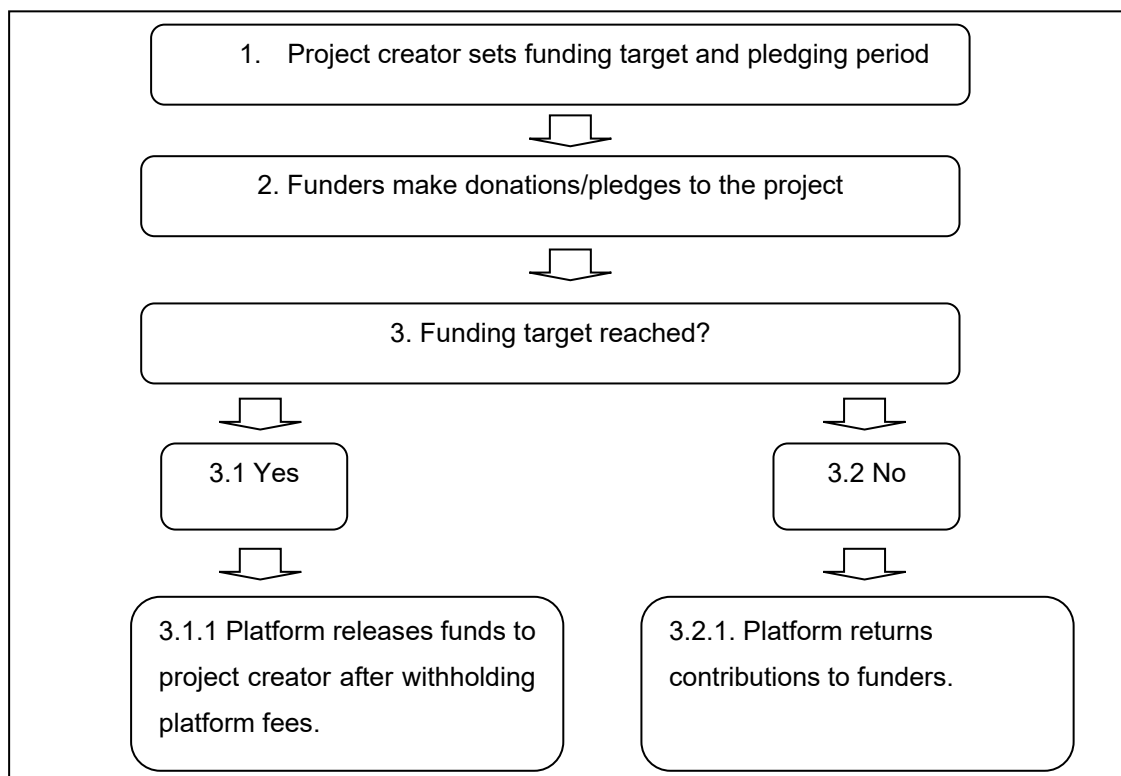


Figure 2: Typical crowdfunding process (Own construct)

There are different crowdfunding models. The models are classified on the basis of the type of return provided in exchange for the funds received. The main crowdfunding models identified are the donation model, the rewards model (including the pre-purchase model), the lending model and the equity model (Battista, 2015:143). The risks and complexities of the crowdfunding transaction increase, with the donation-based model having the least amount of risk and return, and the equity model having the greatest amount of risk and return. The models can be defined as follows:

Donation-based crowdfunding refers to a crowdfunding model where the funders make a donation to the project creator without seeking anything in return (Bradford, 2012:15; Li *et al.*, 2015:3).

Rewards-based crowdfunding refers to a crowdfunding model where the funder receives something (other than interest and shares) in return for the funding provided (Bradford, 2012:16).

Debt-based crowdfunding refers to a crowdfunding model where the funders provide loans to the project creator which are repayable, either at a specified interest rate or without paying interest (Hemer, 2011:14).

Equity-based crowdfunding refers to a crowdfunding model where the funders receive shares in the project company in return for the funding provided. The rewards are either shares of the company, dividends and/or voting rights (Hemer, 2011:14).

1.3 RATIONALE FOR THIS STUDY

There are currently no established policies in South Africa specifically referring explicitly to crowdfunding. There is also no tax legislation in South Africa specifically designed for crowdfunding transactions. The lack of specific policies relating to crowdfunding and the need for research specifically regarding the tax implications of crowdfunding are furthermore evident from the following extracts:

As it stands, the activity of crowdfunding is not regulated in South Africa, there is no specific mention of “crowdfunding” in any piece of legislation, nor is there any proposal of legislation in the pipeline. (Mashinini, 2016)

The question is whether the regulation of equity crowdfunding will kill the initiative in its tracks. There is definitely a place for capital raising in this manner in the South African market, but creating a cost-effective platform that addresses the risks involved while still providing a streamlined alternative for capital raising will prove to be no small task. (Laubscher, 2016)

There are currently no bills or discussions that pertain to defining tax legislation for online crowdfunding in South Africa. (Stevenson, 2011:13)

Since there are no specifically designed tax provisions for crowdfunding transactions in South Africa, the tax implications of such transactions are not certain. Currently the tax implications of these fall within the general tax principles of the ITA. Most of the existing

tax principles were determined before today's technological innovations and expansions and might be outdated. Current tax laws do not always provide clear-cut answers for all crowdfunding models in regard to whether or not some crowdfunding transactions are included or excluded from taxable income. Specific legislation or guidelines, explicitly for crowdfunding transactions, will make the taxation of crowdfunding more efficient, equitable and easier to administer (Battista, 2015:144). It is furthermore important that such legislation and guidelines should also support the Government's goal of economic growth and job creation as stated in the NDP. Tax laws can therefore not be too stringent or overregulating since they will hinder entrepreneurs and small businesses from accessing funds from willing funders.

Authors such as Belleflamme *et al.* (2010:2), Agrawal *et al.* (2013:10-15), Belleflamme and Lambert (2014:3) and Mollick (2014:3) argue that the purpose of crowdfunding is not merely that of funding and that projects engaging in crowdfunding have a wide variety of goals. Overregulation could therefore be counterproductive (Belleflamme & Lambert, 2014:291). It is submitted that it is of utmost importance that a country should have explicit crowdfunding legislation to remain competitive in a global market. Existing tax legislation, not explicitly referring to and/or designed for crowdfunding transactions, might not be sufficiently flexible to accommodate, or even encourage, the use of crowdfunding. There is therefore a knowledge gap regarding whether or not specific tax legislation for taxing crowdfunding transactions should be introduced and, if so, how the tax legislation should be designed.

An in-depth study of the regulatory implications of crowdfunding from a South African viewpoint, with the focus on taxation, is needed in order to be pro-active and to remain competitive in the global market. Ronald Reagan (1986) once said: "[g]overnment's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it". Crowdfunding is moving and it keeps moving. This study aims to assist in establishing and developing policy and a distinct tax framework for the South African crowdfunding industry.

Entrepreneurs use crowdfunding internationally, as well as in South Africa, to access capital. Even though studies have been conducted internationally on the dynamics of crowdfunding, no such studies could be found that have explored crowdfunding in South Africa. According to the knowledge of the researcher, this study will be the first to provide some empirical results regarding the crowdfunding industry in South Africa.

From a theoretical perspective, this study examines different crowdfunding models, crowdfunding taxation and regulation (to a limited extent) locally and internationally. The theoretical knowledge gathered in this way was considered in developing a framework to enhance a crowdfunding policy for the South African crowdfunding industry. From a practical perspective, the proposed findings of this study may assist the National Treasury in creating specific crowdfunding tax legislation and other forms of legislation relating to the crowdfunding industry in South Africa. Furthermore, this study hopes to empower entrepreneurs and small businesses to understand and have certainty regarding the workings and tax implications associated with the different crowdfunding models in South Africa.

1.4 RESEARCH PROBLEM

The following research problem has been formulated for this study: How should South African tax policies be designed for crowdfunding transactions without overregulation to remain competitive in the global market?

1.5 RESEARCH OBJECTIVES

1.5.1 Main objective

The main research objective for this study is to critically evaluate the taxation of crowdfunding transactions in South Africa in order to recommend an appropriate tax framework for crowdfunding in South Africa. The fundamental research question is therefore to consider whether the current taxation provisions in South Africa are

appropriate for the economic environment in the 21st century and – if not – what more optimal set of provisions might be adopted.

1.5.2 Secondary objectives

The main objective of this study is supported by the following secondary objectives:

1. to explore crowdfunding;
2. to compare the tax implications of crowdfunding from an international perspective using the theoretical construct as underpin;
3. to critically analyse the taxation of crowdfunding transactions from a South African perspective using the theoretical construct as underpin;
4. to determine to what extent the current tax legislation dealing with crowdfunding transactions meet the objectives of the South African government, and
5. to provide a framework for the creation/amendment of tax legislation for crowdfunding transactions for South Africa that can be used in the development of formal crowdfunding tax provisions for South Africa.

1.6 RESEARCH QUESTIONS

The following research questions, relating to each of the secondary research objectives above, have been formulated for this study:

Research questions related to secondary research objective 1:

1. What are the different crowdfunding models?
2. What are the reasons and background for using crowdfunding?

Research question related to secondary research objective 2:

3. What are the tax implications of the different crowdfunding models internationally?

Research question related to secondary research objective 3:

4. What are the tax implications of the different crowdfunding models currently in South Africa?

Research question related to secondary research objective 4 and 5:

5. How should South African tax policies be drafted or amended to ensure the effective and efficient taxation of crowdfunding transactions that are aligned with the objectives of the South African government?

1.7 DELINEATION AND LIMITATIONS

This study is delineated as follows:

- This study is conducted from a South African perspective with reference to applicable South African regulation. The main focus is on the Income Tax Act of South Africa.
- Even though reference is made in this study to other similar financing models such as venture capital companies (VCCs) and angel financing, such other forms of financing are not part of the scope of this study and are not dealt with in detail. A VCC is an investment vehicle through which a number of investors can fund a portfolio of business interests. The VCC is intended to be a marketing vehicle that attracts retail investors. Small investors are brought together and thereby investment expertise is concentrated in favour of the small business sector. The VCC merely acts as a financier (e.g. angel investor) to various independent small businesses and start-ups and may not control a qualifying investee company (SA National Treasury, 2008:67-68).
- Crowdfunding referred to in this study relates to crowdfunding where an online platform serves as an intermediary.

1.8 UNDERLYING ASSUMPTIONS

It is assumed that crowdfunding is a valuable tool to access funding for small and medium sized businesses in South Africa.

1.9 SUMMARY AND STRUCTURE

Chapter 1: Introduction and background

This chapter introduced the focus of the study. This was done by providing a background and a brief history of crowdfunding as well as by defining crowdfunding. The research problem and research objectives were also clearly formulated. Crowdfunding has become more prominent with the rapid development of the Internet and social networks. Small businesses started to make more use of crowdfunding after the 2008 financial crisis. Since crowdfunding is on the rise and is a relatively new research field, there is a need for further research from a South African viewpoint in order to remain competitive in the global market.

Chapter 2: Crowdfunding background and overview

A detailed literature review of appropriate sources containing authoritative publications, books, journals, the Internet and related literature is conducted to explain and define the various crowdfunding models. The purpose of this phase is to obtain a thorough understanding of crowdfunding from a global perspective. Furthermore, studies already conducted globally are investigated in order to determine why entrepreneurs and investors make use of crowdfunding. These steps assist in establishing a theoretical platform for the study.

Chapter 3: Research philosophy and research design

The research methodology and research design are discussed in depth in this chapter.

Chapter 4: International developments of crowdfunding

The tax treatment of crowdfunding transactions in the United Kingdom (UK), the United States of America (USA), Australia and New Zealand are discussed in Chapter 4.

Crowdfunding tax incentives that apply in these countries are also discussed in this chapter.

Chapter 5: Policy considerations underpinning crowdfunding in South Africa

In designing a tax framework for crowdfunding transactions in South Africa, it is important that the framework meets the objectives and policy goals of the South African government. The policy objectives of the government are contained in a number of reports which are referred to in Chapter 5.

Chapter 6: An evaluation of the current income tax provisions in South Africa

The current South African tax treatment of each of the identified crowdfunding models is discussed and evaluated from a South African viewpoint in Chapter 6. Other policies and regulations related to crowdfunding such as the Companies Act No. 71 of 2008 (South Africa, 2008) (which has an effect on tax policy) is also discussed and evaluated to a lesser extent. The investigation into other policies and regulations is necessary since these might influence or have a direct impact on the tax consequences of the crowdfunding models.

Chapter 7: The results from the interviews

This chapter provides the research findings from the interviews conducted with the founders of some crowdfunding platforms.

Chapter 8: The empirical results

The results of the survey instrument are provided and discussed. This provides insight into the dynamics of crowdfunding in South Africa in comparison to the available global research in this field.

Chapter 9: Conclusions and recommendations of the study and recommendations for further research

Finally, a summary of the findings, conclusion and recommendations are provided in Chapter 9.

CHAPTER 2: CROWDFUNDING BACKGROUND AND OVERVIEW

2.1 INTRODUCTION

Crowdfunding emerged and developed since the late 1990s within the Internet community but remained largely unnoticed until around the year 2006 (Hemer, 2011:2). Crowdfunding is defined in Chapter 1 as “an open call, essentially through the Internet, for the provision of financial resources either in form of donation or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes” (Belleflamme *et al.*, 2014:588). Crowdfunding has been referred to as the combination of two economic theories, namely crowdsourcing and microfinance (Bradford, 2012:29; Pekmezovic & Walker, 2016:365; Li *et al.*, 2015:2). Crowdsourcing is “small contributions from a large number of people” whereas micro-lending is funding provided to “very small entrepreneurial ventures” (Bradford, 2012:29). Because of crowd support, the size of the investment per investor is small with crowdfunding, whereas the total amount required to be financed is relatively small under a microfinance model (Pekmezovic & Walker, 2016:365-366). Since the provision of small amounts is economically feasible through crowdfunding, the risk exposure of investors is reduced (Agrawal *et al.*, 2013:6).

The four major stakeholders of crowdfunding activities are the funders, the project creators (fund seekers, entrepreneurs, borrowers, etc.) the platform, and the governments that should protect the interests of the general public and regulate the financial market operations (Li *et al.*, 2015). There are different crowdfunding models in which these participants participate, which are discussed below.

2.2 DIFFERENT MODELS OF CROWDFUNDING

The main crowdfunding models, listed in order of flexibility and complexity, are: donation-based crowdfunding, rewards-based crowdfunding, debt-based crowdfunding and equity-based crowdfunding (Li *et al.*, 2015:3). These models can furthermore be divided into two main categories: crowd sponsoring and financial reward crowdfunding or investment crowdfunding. The donation model and the rewards model fall within crowd sponsoring.

The debt model and the equity model are referred to as financial reward crowdfunding. Since the financial reward crowdfunding models carry a higher risk, investor protection is an important consideration in those models (Pekmezovic & Walker, 2016:361).

Haas, Blohm and Leimeister (2014:2) argue that this classification of crowdfunding models done by researchers, is mainly based on investment decisions and motivation of investors, as well as motivations of fund seekers (project creators). Haas *et al.* (2014:2) argue that the research on crowdfunding intermediaries (the crowdfunding platform) has been largely neglected. In their study, they present crowdfunding as being embedded in the theory of two-sided markets and financial intermediation (the two-sided market approach is also referred to by Viotto, 2015:35). By using the two-sided market theory, crowdfunding can be seen as a two-sided market since it involves two groups of agents, namely capital-seeking (project creators) and capital-giving (funders) agents that are interacting on the crowdfunding intermediary's platform (Haas *et al.*, 2014:4). The exchange relationships and functionalities of crowdfunding is embedded in the theory of financial intermediation and builds on models of resource allocation by a market mechanism between those that seek and give capital (Haas *et al.*, 2014:4).

Most researchers and publications, however, refer to the four crowdfunding models which are the donation model, the rewards model (including the pre-purchase model), the lending model (also referred to as the debt model) and the equity model (also referred to as the investment model) (Bradford, 2012:14-15; Hemer, 2011:9). These models and classifications are also referred to in this study. Each of these models is discussed below.

2.2.1 Donation model

With the donation-based crowdfunding model, the funders make a donation to the project creator without expecting anything in return (Bradford, 2012:15; Li *et al.*, 2015:3). This model is similar to existing traditional funding campaigns of charities and non-governmental organisations (NGOs) (Belleflamme *et al.*, 2015:14). According to Belleflamme, Omrani and Peitz (2015:12), it can sometimes be difficult to distinguish between the donation model and the rewards model. This is because simply mentioning

the name of the funder can also be seen as a reward, which might then rather be classified as rewards-based crowdfunding.

Examples of donation-based crowdfunding platforms in South Africa include BackaBuddy, Different.org and ADDaBIT¹. BackaBuddy is a registered non-profit company which had already raised R111 872 138.30 by 8 July 2019 for 8 340 projects from 12 562 funders (“BackaBuddy”, n.d.). Some crowdfunding platforms like Jumpstarter and Thundafund support both donation and rewards-based crowdfunding. BackaBuddy charges a 4.6% (including VAT) administration fee on all funds raised through the platform by registered non-profit organisations. The fee is increased to 5.75% (including VAT) for individuals raising funds on the platform who are not linked to a registered non-profit organisation. In addition, bank charges are levied by the respective financial institutions as follows: debit/credit card – 5%; iPay – 5%; PayPal – 5.5%; and EFT – R12 flat rate². Funds will be paid to the project creator regardless of whether or not the target has been met, and there is also no time restriction on the duration of a project (BackaBuddy, n.d.).

Table 2 summarises the data obtained from the websites of some platforms as at 21 April 2020.

Table 2: Summary of platform data as at 21 April 2020 (Own construct)

Platform	Number of projects	Number of funders	Amount raised	Crowdfunding model
BackaBuddy	13 692	18 228	R162 002 743.06	Donation
Different	Not available	Not available	Not available	Donation
Jumpstarter	19	Not available	R581 420	Reward
Thundafund	1 224	22 513	\$3 240 657	Reward
Uprise.Africa	Not available	Not available	Not available	Equity

¹ Footnotes were used to enhance the ease of reading and the presentation of this study. This was considered appropriate, especially where references to various legislations and specific case law were used. ADDaBIT, however, does not make use of traditional crowdfunding. It is a social savings investment platform where money is reinvested by a fund manager (a certified financial planner).

² <https://www.backabuddy.co.za/fees>

The following table summarises the data obtained during the initial phases of this research from the websites of some platforms as at 6 April 2018.

Table 3: Summary of platform data as at 6 April 2018 (Own construct)

Platform	Number of projects	Number of funders	Amount raised	Crowdfunding model
BackaBuddy	3 371	7 964	R62 153 445	Donation
Jumpstarter	22 ³	1 890	R465 665	Reward
Thundafund	349	16 241	R18 811 620 (\$1 460 756) ⁴	Reward
Uprise.Africa	Not available	Not available	R1 383 400	Equity

Based on the information indicated by the available data on the specific dates, the crowdfunding industry in South Africa is growing. The amount raised by BackaBuddy increased by 160%, the number of projects increased by 306%, and the number of funders increased by 133% over the two years. For Jumpstarter, the amount raised increased by almost 25%. The amount raised by Thundafund increased by 122%, the number of projects increased by 251% and the number of funders increased by 39% over the two years.

Project creators that use the donation, reward and pre-purchase crowdfunding models, predominantly use a “threshold pledge model” which is also referred to as the “all-or-nothing” model (Hemer, 2011:15-16). Under the threshold pledge model, funders give pledges which are then only released as payments from an escrow account to the project’s account once the threshold set for the project has been reached or exceeded at the end of the set period (Hemer, 2011:15). Under this model, funds are returned if the project creators do not reach their stated goal. Another funding model used by some platforms is

³ The number of projects decreased for some unknown reason and therefore the difference was not calculated.

⁴Converted at the average exchange rate of R12.878 for April 2018 obtained from <https://www.sars.gov.za/AllDocs/LegalDoclib/Rates/LAPD-Pub-AER-2012-02%20-%20Average%20Exchange%20Rates%20Table%20A.pdf>.

the “all-and-more” model which allows project creators to keep all funds even if the stated funding goal was not achieved (Gerber & Hui, 2013:4).

2.2.2 Rewards model

Rewards-based crowdfunding refers to a crowdfunding model where the funder receives something (other than interest and shares) in return for the funding provided (Bradford, 2012:16). This crowdfunding model is commonly used by artists and entrepreneurs who are unable to access capital from traditional sources of funding (Ganatra, 2016:1431). By using the crowdfunding platform, project creators can broadcast their ideas by making use of social media (Ganatra, 2016:1431).

The rewards and pre-purchase models are similar since, with both models, the funder receives something in return for the contribution made (Bradford, 2012:16). With the pre-purchase model, the funder receives the product that the entrepreneur (fund seeker) is creating whereas the reward under the rewards model can be anything (Bradford, 2012:16). Platforms hosting these crowdfunding models are the most popular platforms (Bradford, 2012:16).

South African rewards-based crowdfunding platforms include Jumpstarter and Thundafund. The information provided on the website of Thundafund, one of South Africa’s largest crowdfunding platforms making use of the rewards crowdfunding model, was investigated to determine how the crowdfunding model works. As at 3 May 2019, the platform had 22 650 supporters and had raised \$1 826 112 in funds for 550 funded projects. Thundafund has thirteen specific project categories under which a project should be registered: art and photography, community, craft, design, events, fashion, film and video, food and beverages, media and publishing, music, performance, sport and technology and games. Funders make contributions to the project in return for a reward, which can either be retail items, recognition or access to something specified. Thundafund operates an “all-or-nothing” crowdfunding model which means that the funds will only be paid to the project creator if the minimum amount (referred to as the “tipping point”) has been reached. The tipping point is the minimum amount required by the project creator to

make the project work. Another upper limit, the “dream goal” amount is set which is the amount needed to “make your vision come to life”.

The duration of the campaign can vary between 30, 45 or 60 days. If the minimum amount is not reached within the duration of the campaign, the funders’ contributions are refunded by Thundafund, after subtracting banking fees. Once the project is successfully funded, Thundafund receives a commission on the final amount received by the campaign. The percentage of the commission depends on whether the project creator is an NGO, an individual or an organisation such as a company, and is 5% of the funded amount for certified NGOs and 7% of the funded amount for individuals and organisations. Third party fees and administration transaction fees are also payable and depend on the payment method used. These costs can range from 3% to 5.5%, and are paid by the project creator. Electronic fund transfers carry a R10 fee per transaction. (“Thundafund”, n.d.).

Belleflamme *et al.* (2015:15) submit that, due to the charges of crowdfunding platforms of successfully funded projects, most donation-based crowdfunding platforms are for profit. Although this adds to the cost of the campaign in comparison with traditional ways that do not make use of the platform, the personal value derived by funders (from a better match between the funders’ taste and the campaign) must be larger than the payment to the platform (Belleflamme *et al.*, 2015:15).

Kickstarter, a USA-based crowdfunding platform, was launched on 28 April 2009, as a for-profit corporation. It is the platform most studied and referred to in research papers. The platform was reincorporated during 2015 as a Benefit Corporation⁵. The reason for the change is stated on the website:

Until recently, the idea of a for-profit company pursuing social good at the expense of shareholder value had no clear protection under USA corporate law, and certainly no mandate. Companies that believe there are more important goals than maximizing shareholder value have been at odds with the expectation that for-profit

⁵ <https://www.kickstarter.com/charter>

companies must exist ultimately for profit above all. Benefit Corporations are different. Benefit Corporations are for-profit companies that are obligated to consider the impact of their decisions on society, not only shareholders. Radically, positive impact on society becomes part of a Benefit Corporation’s legally defined goals⁶.

As at 20 February 2020, the statistics on the Kickstarter platform showed that \$4 798 194 011 was pledged in total to projects listed on Kickstarter, 177 651 successful projects were funded, there was a total of 17 457 963 backers of which 4 768 157 were repeat backers, and a total of 59 544 158 pledges were received⁷. These statistics are indicative that crowdfunding cannot simply be ignored and that it is moving across the globe.

Since most studies conducted globally refer to Kickstarter, the information copied from the platform of Kickstarter⁸ was compared to the information copied from the SA based platforms, Jumpstarter⁹ and Thundafund¹⁰ (see Table 4). This was done to determine whether the basic workings of crowdfunding is the same in SA than globally.

Table 4: Comparison between Jumpstarter, Thundafund and Kickstarter (Own construct)

Jumpstarter	Thundafund	Kickstarter
What is Jumpstarter / Kickstarter		
<p>Jumpstarter is a registered non-profit organisation (NPO 153-319) funding platform through creative projects for individuals, charities and businesses.</p> <p>Jumpstarter is a new way to fund creative projects for individuals, charities and businesses.</p>	<p>Thundafund is South Africa’s leading crowdfunding platform for creative and innovative ventures.</p> <p>Thundafund Backers back initiatives they are attracted to by pledging money, time, or both</p>	<p>Kickstarter’s mission is to help bring creative projects to life. We measure our success as a company by how well we achieve that mission, not by the size of our profits. That’s why we reincorporated Kickstarter as a Benefit Corporation in 2015.</p>

⁶ <https://www.kickstarter.com/blog/kickstarter-is-now-a-benefit-corporation>

⁷ <https://www.kickstarter.com/help/stats?ref=hello>

⁸ <https://www.kickstarter.com/press?ref=global-footer>

⁹ <https://jumpstarter.co.za/faq/>

¹⁰ <https://blog.thundafund.com/how-does-thundafund-work/faqs/>

Jumpstarter	Thundafund	Kickstarter
<p>We believe that</p> <ul style="list-style-type: none"> • A good idea, communicated well, can spread fast and wide. • A large group of people can be a tremendous source of money and encouragement. 	<p>in return for rewards. Backers also share the various project messages to their own communities and social networks. (And voilà, an initial market is created.)</p> <p>Thundafund couples projects with business and mentorship support services. Mentorship is as important as raising the capital to build successful enterprises.</p> <p>Thundafund believes that by changing the way entrepreneurial funding works, and by making this transparent and inclusive, we can build trust and loyalty between entrepreneurs and their customers, and thereby grow economies and create jobs. We will showcase the best of African creativity and enterprises so that people are inspired to be part of entrepreneurial success. Backers change the world with R100. This is not about charity. This is about change.</p>	<p>Kickstarter PBC is a funding platform for creative projects. Everything from films, games, and music to art, design, and technology. Kickstarter is full of ambitious, innovative, and imaginative ideas that are brought to life through the direct support of others.</p> <p>Everything on Kickstarter must be a project with a clear goal, like making an album, a book, or a work of art. A project will eventually be completed, and something will be produced by it.</p> <p>Kickstarter is not a store. Backers pledge to projects to help them come to life and support a creative process. To thank their backers for their support, project creators offer unique rewards that speak to the spirit of what they're hoping to create.</p>
How does the platform work?		
<p>Creative projects are funding on Jumpstarter at any given time. Each venture is individually designed and crafted by the person behind it. The filmmakers, musicians, artists, and designers you see on Jumpstarter have complete control and responsibility over their projects. They spend weeks building their project pages, capturing their movie clips, and brainstorming what benefits to offer backers. When they're ready, creators launch their</p>	<p>Step 1: The Thundafund team works with each individual to understand the idea/project; its funding needs and crowdfunding targets; what the money will be used for, and how results will be measured in terms of social and economic impact.</p> <p>Step 2: Each project devises a variety of backer levels and rewards in return for Backers'</p>	<p>A project is a finite work with a clear goal that you'd like to bring to life. Think albums, books, or films.</p> <p>The funding goal is the amount of money that a creator needs to complete their project.</p> <p>A creator is the person or team behind the project idea, working to bring it to life.</p>

Jumpstarter	Thundafund	Kickstarter
<p>project and share it with their community.</p> <p>Every project creator sets their project's funding goal, donation rewards and deadline. If people like the project, they can donate money to make it happen. If the project succeeds in reaching its funding goal in allocated timeframe, the Project Creator is paid out.</p> <p>Jumpstarter is powered by a unique 100%-or-nothing funding method where projects must be fully-funded or no money changes hands.</p>	<p>support. These rewards can be items such as unique events; goods and services; money-can't-buy experiences and objects. The type of reward that a backer receives corresponds with the amount of money they give.</p> <p>Step 3: The project goes live on Thundafund and crowdfunding can commence! The project defines a target time period and two milestones (Tipping Point and Dream Goal) within which to raise funds. If the financial target is not met within the tipping point, funds pledged by Backers are returned.</p> <p>Thundafund operates a "Rewards-Based", "All-or-Nothing" crowdfunding model. All projects on Thundafund are required to reach their Tipping Point before their project closes in order to receive all their funds. If their target is not reached all backers of the project will be reimbursed minus the banking fees.</p>	<p>Backers are folks who pledge money to join creators in bringing projects to life. Kickstarter is not a store, backers support a creative process.</p> <p>Rewards are a creator's chance to share a piece of their project with their backer community. Typically, these are one-of-a-kind experiences, limited editions, or copies of the creative work being produced.</p> <p>Funding on Kickstarter is all-or-nothing. No one will be charged for a pledge towards a project unless it reaches its funding goal. This way, creators always have the budget they scoped out before moving forward.</p>
Why is funding all-or-nothing?		
<p>Every Jumpstarter project must be 100% funded before its time expires or no money changes hands (received Jumpstarter Project donation funds, become usable for other live Jumpstarter Projects as credits/pledges).</p> <p>Why?</p> <ul style="list-style-type: none"> • <i>It's less risk for everyone.</i> If you need R50,000 its tough having R20,000 and 	<p>This ensures that Backers only commit their funds towards projects that have sufficient financial backing from the crowd to actually happen.</p>	<p>All-or-nothing funding is a core part of Kickstarter and has a number of advantages:</p> <p>It's less risk for everyone. If a project doesn't reach its funding goal, creators will not be expected to complete their project without the funds necessary to do so, and backers will not be charged.</p>

Jumpstarter	Thundafund	Kickstarter
<p>a bunch of people expecting you to complete a R50,000 project.</p> <ul style="list-style-type: none"> • <i>It allows people to test concepts (or conditionally sell stuff) without risk.</i> If you don't receive the support you want, you're not compelled to follow through. This is huge! • <i>It motivates.</i> If people want to see a project come to life, they're going to spread the word. 		<p>It motivates. Adding a sense of urgency motivates your community to spread the word and rally behind your project.</p> <p>It works. Of the projects that have reached 60% of their funding goal, 98% were successfully funded. We find that projects either realise or surpass their goal, or they never fully take off.</p>
Can it be used for fund anything?		
<p>We allow creative projects in the worlds of Art, Comics, Dance, Design, Fashion, Film, Food, Games, Music, Photography, Publishing, Technology, and Theatre.</p> <p>Everything on Jumpstarter must be a project. A project has a clear goal, like making an album, a book, or a work of art. A project will eventually be completed, and something will be produced by it.</p> <p>Jumpstarter allows charity projects. Check out our project guidelines for details.</p>	<p>Creative and innovative projects that fit into our 13 categories and are able to offer rewards to backers. Thundafund has specific project categories: Art & Photography, Community, Craft, Design, Events, Fashion, Film & Video, Food & Beverages, Media & Publishing, Music, Performance, Sport, Technology & Games.</p>	<p>We allow creative projects in the worlds of Art, Comics, Crafts, Dance, Design, Fashion, Film & Video, Food, Games, Journalism, Music, Photography, Publishing, Technology, and Theatre.</p> <p>Everything on Kickstarter must be a project. A project has a clear goal, like making an album, a book, or a work of art. A project will eventually be completed, and something will be produced by it.</p> <p>Kickstarter does not allow projects to fundraise for charity or offer financial incentives. Check out our rules for details.</p>
What are the fees?		
<ul style="list-style-type: none"> • If a For-Profit project is successfully funded, Jumpstarter applies a 7% fee to the funds collected. <i>Payments pledged exceeding R250, are refundable.</i> • If a registered Non-Profit Organisation project is successfully funded, Jumpstarter applies a 3.5% fee to the funds collected. <i>Payments pledged exceeding R250, are refundable.</i> • If ISASA or RSA Public School's project is successfully funded, Jumpstarter applies a 3.5% fee to the 	<p>If, and only if, your funding is successful by reaching their Tipping Point (Milestone 1) does Thundafund receive a fee of either 7% for regular projects or 5% for registered NGOs, exclusive of VAT.</p> <p>3rd party fees and administration transaction fees, depending on the payment method, can range from 3% –</p>	<p>If a project is successfully funded, Kickstarter applies a 5% fee to the funds collected. All pledges are processed securely by our third-party payments partner, Stripe. The payment processing fees work out to roughly 3-5%.</p> <p>If the project does not reach its funding goal, there are no fees.</p>

Jumpstarter	Thundafund	Kickstarter
<p>funds collected. <i>Payments pledged exceeding R250, are refundable.</i></p> <p>In South Africa, the pledged donations will be processed by PayGate, a third-party payments processor. We are a registered non-profit organisation and have a special, reduced fee structure with PayGate. These payment processing fees work out to roughly 1.5-3.9%.</p> <p>In South Africa, we accept credit and debit cards.</p> <p>If international payments are sent via credit and debit cards, it is important the user's card has 3D secure verification. If funding isn't successful, there are no fees.</p>	<p>5.5%, which is paid by the Project Creator. The payment method EFT transfers carries a R10 fee per transaction.</p> <p>If the Tipping Point (Milestone 1) is NOT reached, then all Backers have the opportunity to support another project or get their cash back.</p>	

From the comparison above, it is clear that the basic workings of the platforms are the same. The only significant difference is that Jumpstarter is registered as a non-profit organisation, while Thundafund and Kickstarter are not.

2.2.3 Debt model

Debt-based crowdfunding refers to a crowdfunding model where the funders provide loans to the project creator which are repayable, either at a specified interest rate or without paying interest (Hemer, 2011:14; Viotto, 2015:36). The interest rate that each investor receives is determined based on the amount of the investor's bid to the loan (World Bank, 2013:24). The project creator's average interest rate (calculated as the weighted average of all accepted bids) is determined once the project is fully funded. The bids with lower interest rates therefore have a higher chance of being accepted which will then lower the cost of capital for the project creator (World Bank, 2013:24).

Peer-to-peer lending is an example of this type of crowdfunding. With peer-to-peer lending a platform, rather than a traditional bank, acts as an intermediary between the borrower and the lender (Belleflamme *et al.*, 2015:13). In the UK, Zopa was the first to offer this kind of service in 2005. Prosper, a USA-based platform, is currently regarded as the market leader in peer-to-peer lending (Pekmezovic & Walker, 2016:359).

RainFin Proprietary Limited (RainFin) was the first online marketplace lending platform in South Africa (Shadrach-Razzino *et al.*, 2017). RainFin is registered with the National Credit Regulator (NCR) as a credit provider and with the Financial Sector Conduct Authority (FSCA) in regard to financial service regulations. From the information provided on the platform on 26 February 2020, it was determined that borrowers should complete an online registration and application for a loan. Online data and technology is then used by the platform to complete a risk assessment and to determine a credit rating for the borrower. Qualified loans are published on the platform's credit marketplace after a combination of manual and algorithmic moderation was performed to qualify loan requests. Investors (institutional and retail) may then place orders to purchase participation notes, which are directly linked to the economic interest on loans. A single offer is presented to the borrower and, after the acceptance of the offer, the orders are concluded and the participation notes are issued (<https://www.rainfin.com/About/Howitworks>).

As an origination agent, RainFin charges an initiation fee of up to 2.85% of the loan amount that is paid upon the issuance of the loan on behalf of the lender. Investors are charged a service fee of 1.15% per annum of the capital and interest on the monthly repayments for 6 and 24-month loans and 0.91% for 12-month loans. In addition, the lender charges a monthly borrower account fee of R60 as part of the administration services for the management of the account, the collection of payments and other administration expenses (<https://www.rainfin.com/About/Fees>).

2.2.4 Equity model

Equity-based crowdfunding refers to a crowdfunding model where the funder receives shares in the project company in return for the funding provided by the funder (Hemer,

2011:14). Backing new business is more affordable with equity crowdfunding since the emerging company does not have to rely on a substantial investment from a small number of venture capitalists or angel investors but can turn to a large number of investors for small contributions (Pekmezovic & Walker, 2016:358).

The UK was the first country that adopted equity crowdfunding and Crowdcube was the first platform (De la Viña & Black, 2018:85). South Africa's first equity-based crowdfunding platform was Uprise.Africa which was launched in 2017 (Timm, 2017). Intergreatme's equity crowdfunding campaign raised R32 601 000 through equity crowdfunding on this platform, exceeding the project's initial target of R24 million (Timm, 2019).

2.2.5 Other models

With the expansion of crowdfunding, various other models of crowdfunding arose. One such model is royalty-based crowdfunding, where a fraction of the revenues or profits is offered instead of equity shares (Belleflamme *et al.*, 2015:13). Hybrid models, which are combinations of some models, are also sometimes used. These other models are not discussed in this study because their basic principles and processes are similar to the main models discussed.

2.3 BEHAVIOUR OF FUNDERS

The success of a crowdfunded project is determined based on whether or not the required funding was received from the funders. Various studies have been undertaken to investigate the behaviour of funders. Agrawal, Catalini and Goldfarb (2011:7) conducted an empirical study where projects of artists on a platform called Sellaband were analysed over a period of three years, from the platform's launch in August 2006 until September 2009. It was determined that the distribution of investments in the projects was highly skewed since 34 projects raised 73% of the total funds raised on the platform (Agrawal *et al.*, 2011:7). The 34 project creators were distributed over five continents and the funders represented 80 countries. The project creators and the funders were,

however, mainly located in Europe and the USA (Agrawal *et al.*, 2011:9). By studying the 34 projects further, it was determined that funders within 50km of the project creator invested on average more per funder than those situated further.

Local funders (funders within 50km of the project creator) were more likely to invest in a specific project in contrast to other more distant funders and were also most likely to invest in the early stages of a project (Agrawal *et al.*, 2011:10,15-16,19). This was attributed to the fact that friends and family (who formed part of the local funders) are more likely to invest in early stages in comparison to unrelated funders, since they know the investor and the information asymmetry is therefore assumed to be minimal (Agrawal *et al.*, 2011:16). However, distant funders' propensity to invest increased as the project creator accumulated capital. Their investment, on aggregate, accounted for the vast majority of the total investments received by the project creator (Agrawal *et al.*, 2011:10,15). Agrawal *et al.* (2011:20) suggests that the early investments serve as a signal of entrepreneurial commitment which will make it more likely for other funders to invest. It was concluded that funding is therefore not geographically constrained and is independent of geographic distance between the funder and project creator (Agrawal *et al.*, 2011:19).

In a study conducted by the World Bank (2013:26) it was also concluded that geography plays a less significant role in promising projects. According to Agrawal *et al.* (2013:6), economic theory helps to explain the above behaviour and the increase in crowdfunding activity. The use of the Internet decreases the costs of matching funders and creators (due to lower online search costs) as well as the costs of communication, making it easier for the funders to monitor the progress of the project (Agrawal *et al.*, 2013:6).

The risk exposure of funders is also reduced because funding is provided in small amounts by a number of different funders (Agrawal *et al.*, 2013:6). Koch and Siering (2015:11-12) conducted an empirical study based on the data from the USA-based platform Kickstarter. They determined that the depth of the project description, the images and videos used in the project description, and the fact that the founder had previously backed other projects, influenced the funding success of the project positively (Koch &

Siering, 2015:11-12). It was also determined that the likelihood of a successfully funded project decreases with the increasing of the funding goal (Koch & Siering, 2015:12).

2.4 REASONS FOR USING CROWDFUNDING

The benefits of using crowdfunding are discussed below. The benefits are mainly related to the project creator with some intrinsic benefits for the funder.

2.4.1 Access to financing

It is often difficult for small businesses to obtain an adequate number of investors in a cost-effective manner (Heminway & Hoffman, 2011:931). Crowdfunding is an innovative tool used by entrepreneurs and small businesses to access capital from sources other than venture capital and the financial service and banking industry (Mollick, 2014:2). According to Howe (2009:247), crowdfunding connects people with money to those who need it, and therefore even out hierarchies.

Crowdfunding is already an established method of accessing funding in the creative industry (Hemer, 2011:27). Hemer (2011:29) argues that crowdfunding cannot substitute traditional sources of funding (particular in later stages of the entrepreneurial project) but can complement them. Based on a study conducted by the World Bank, the following diagram indicates how crowdfunding is used, which supports Hemer's argument.

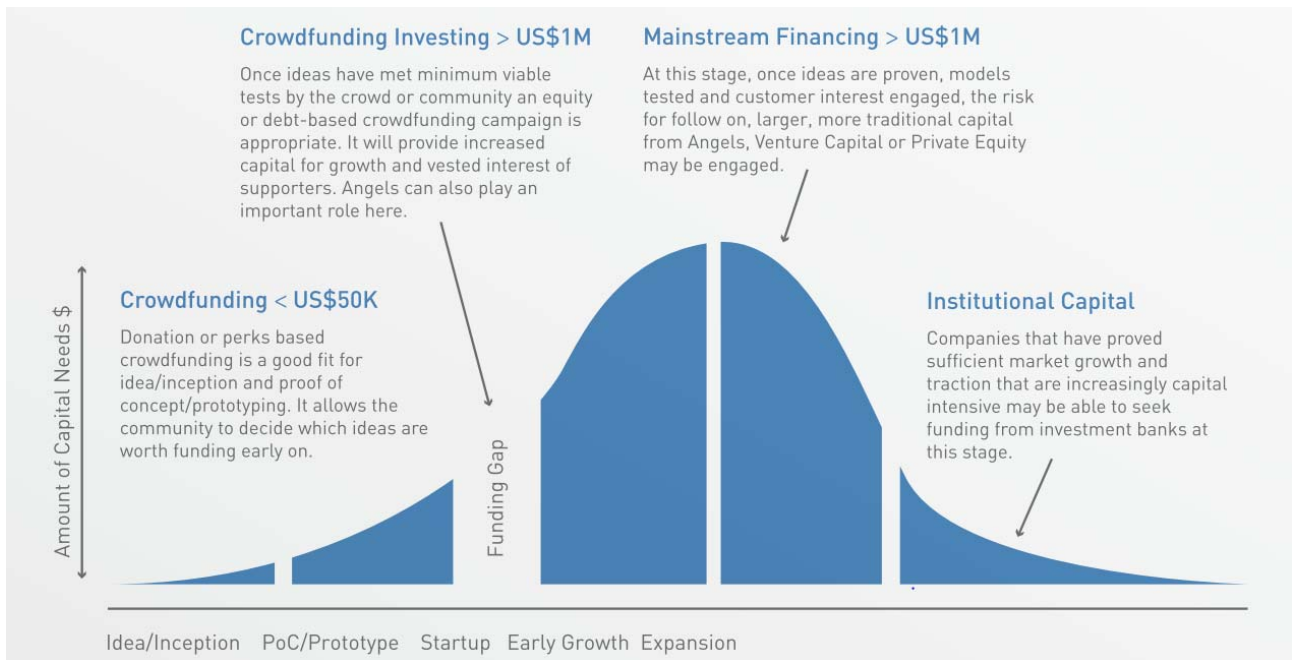


Figure 3: Crowdfunding adoption curve (World Bank, 2013:16)

Crowdfunding can therefore supplement traditional sources of funding and is especially important in the early stages of a business where traditional sources of funding are not normally easily accessible due to the lack of collateral. According to Belleflamme *et al.* (2015:18), entrepreneurs often use the success of their crowdfunding campaign to signal their creditworthiness in order to facilitate their access to traditional sources of funding such as bank loans and venture capital.

The World Bank (2013:22) further makes it clear that there is a difference between micro-finance and social (peer-to-peer) lending *versus* crowdfunding which is illustrated in Figure 4 below.

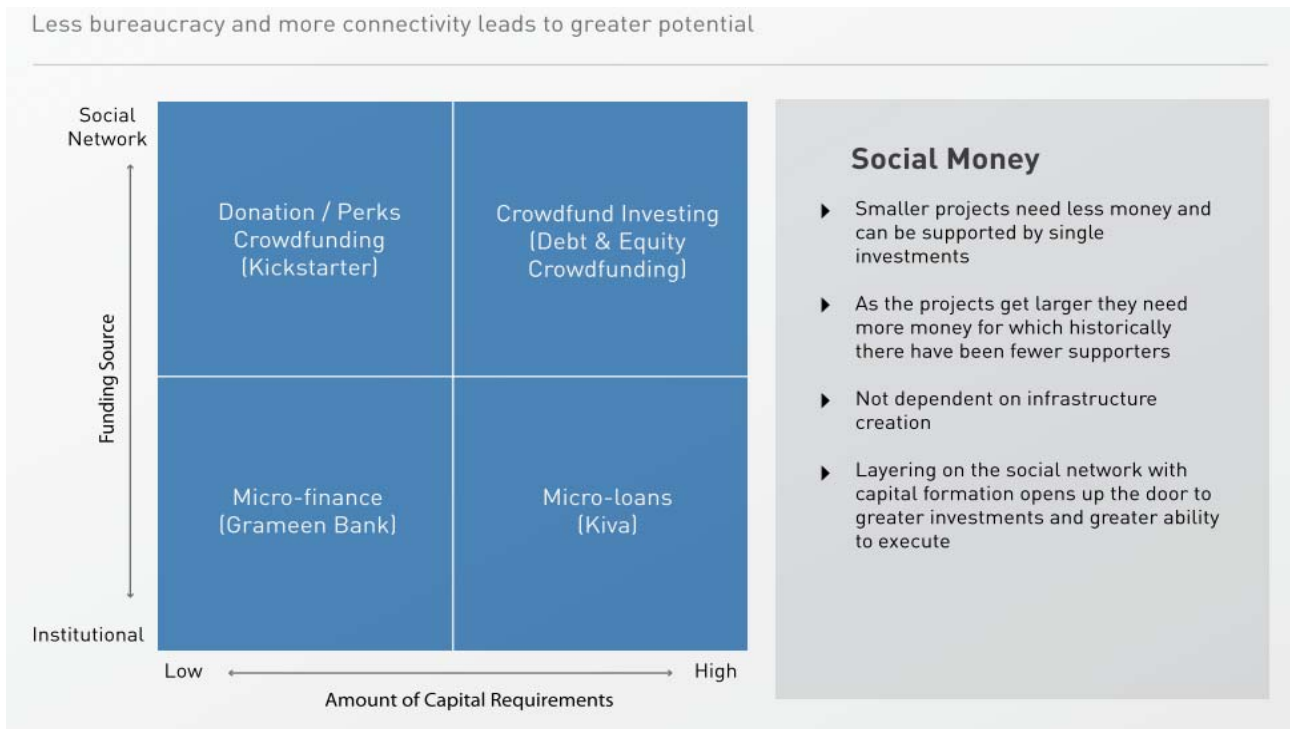


Figure 4: The amount of capital grows with the social network (World Bank, 2013:22)

Micro-loans (peer-to-peer lending) is a subcategory of micro-finance that allows ordinary people to lend around the world in contrast to micro-finance which normally consists of organisations that provide small-scale finance to the poor (World Bank, 2013:21). Crowdfunding fills the gap between micro-finance and micro-loans on the one hand, and institutional investors on the other, since larger amounts of capital are provided to start-ups and small businesses through crowdfunding (World Bank, 2013:22). The World Bank (2013:34) also explored the suitability of the different crowdfunding models for the developing world and provided the following guidelines as displayed in Figure 5 below.

	Most suitable project type	Average funding sought (US\$)	Suitable for exploration in developing world?	Suitable for high-growth, innovative start-ups?
Donation-Based Crowdfunding	Arts	< \$10,000	Yes	No, if capital requirements are > \$10,000
Reward/Pre-sale Crowdfunding	Project, Product	< \$100,000	Yes	Yes, as a testing ground for proof of concepts
Microfinance	Micro development	< \$1000	Yes	No if capital requirements are > \$1000
Social Lending	Micro development	< \$50,000	Yes	Only if capital requirements are < \$50,000
Crowdfund Investing/Equity	Technology Innovation	< \$250,000	Yes with the right infrastructure	Yes

Figure 5: Suitability of crowdfunding models for the developing world (World Bank, 2013:34)

Based on the analysis in Figure 5 above, all the crowdfunding models are therefore suited for the developing world, including South Africa.

According to Agrawal *et al.* (2013:10-11), the use of the Internet reduces the cost of capital for the creator, because creators are more effectively and efficiently matched with funders who have the greatest willingness to pay because access to capital is not limited to a local pool of potential funders close to the creator's location. Furthermore the provision of more information through an online crowdfunding project, increases the funders' willingness to pay which lowers the cost of capital for the creator (Agrawal *et al.*, 2013:10-11).

2.4.2 Stimulation of the economy

If new businesses are properly funded, they can commence and continue operations which stimulates economic growth through providing employment opportunities (Heminway & Hoffman, 2011:932). The small and medium-size business sector are very important for the promotion of employment, economic growth and changing the apartheid legacy patterns of business ownership in South Africa (Fatoki, 2014a:922; South Africa. National Planning Commission, 2011:117). Crowdfunding is an open call to any member

of the public and therefore democratises access to funding and provides investment opportunities, irrespective of a person's demographics.

2.4.3 Market testing and validation of products or services

With the rewards-based and pre-purchase crowdfunding models, project creators receive feedback from various funders and potential funders regarding the project that they want to create. The feedback received and interest shown might serve as an early indicator of whether or not the product, once created, will be successful and will be well accepted by the market (World Bank, 2013:26-27). A lack of demand for or interest in a project can protect project creators from suffering further losses from investing additional capital and resources in a project that is doomed to fail (Mollick, 2014:3).

2.4.4 Brainstorming

Since the project creator provides status updates on the platform regarding the project, funders can provide their insight and share their knowledge and skills (World Bank, 2013:27). According to Bessièrè and Stéphanie (2016:68-69), start-ups can benefit from crowdfunding as a cognitive resource: it can be a means of acquiring external capabilities in order to improve the product technology, revise the business model, and so forth.

2.4.5 Developing a market early in the start-up process

Crowdfunding has been used to create interest in new projects in early stages of development (Mollick, 2014:3). Because of the herding effect of crowdfunding, attention can be drawn to a particular project that is successfully funded, thereby increasing the pool of potential clients.

2.4.6 Intrinsic motivations

Funders are not motivated only by material and extrinsic rewards (such as products or financial return) but also by immaterial and intrinsic motivations (Li *et al.*, 2015:4; Hemer, 2011:14). According to Hemer (2011:14), intrinsic rewards includes that the funder:

- can personally identify with the project's subject and goals,
- contributes to a project which is socially important,
- obtains satisfaction from being part of a specific community,
- obtains satisfaction from experiencing the success of the funded project,
- enjoys the interaction with the project's team,
- enjoys to contribute to an innovative project or to be among the pioneers of new technology or business,
- can expand his/her personal network, or
- has an expectation of attracting funders in return for his/her own crowdfunding project.

Since participation in crowdfunding activities is social, funders therefore also derive community benefits from participating.

2.5 RISKS OF USING CROWDFUNDING

According to Gilson (2002:13), all financing methods pose three problems that need to be addressed, namely, uncertainty, information asymmetry between funders and the project creators (entrepreneurs) and opportunism in the form of agency costs¹¹. He explains this based on the characteristics of a venture capital company since in an early stage of a venture capital company, the outcome of the efforts and quality of decisions made by the management of the company is yet to be determined (Gilson, 2002:13-14). This also applies to a crowdfunding project, since the main purpose of crowdfunding is for small businesses (start-ups) to gain access to funding. The risks of using crowdfunding are discussed below.

¹¹ According to Schwartz (2015a:629), these three problems are generally accepted in the literature.

2.5.1 Losses suffered by investors

According to Mollick (2014:6), projects that fail tend to fail by large margins and projects that succeed tend to succeed by relatively small margins. If a small business fails, investors suffer the loss of the amount invested (Heminway & Hoffman, 2011:933). This is however not only limited to crowdfunding transactions, but is a risk that is inherent to small businesses in general and should not be seen as a risk unique to crowdfunding (Bradford, 2012:99).

2.5.2 Fraud

Although fraud will always be a risk inherent in any transaction, the World Bank (2013:44, 46) reports that data from major existing platforms indicate that no successful fraud has been committed. The transparency inherent in crowdfunding leads to funders revealing fraud and results in the removal of fraudulent funders from the platforms within 24 hours (World Bank, 2013:44). The World Bank (2013:48-49) compiled the following table (Table 5), setting out protective measures that have been enacted internationally to mitigate potential fraud:

Table 5: Protective measures against potential fraud (World Bank, 2013:48-49)

Type	Risk	Rationale	Mitigation Tactic
Business	Fraud	The securities markets have examples of fraud	<ul style="list-style-type: none"> • Background checks for issuers • Mandatory auditing, financial disclosures and business reviews • Requiring all-or-nothing financing (prevents fraudsters from raising money and then disappearing when donors ask difficult questions) • Restricting or monitoring social media communication about offerings • Requiring all crowdfund raising to take place on portals that are registered with a national regulatory body that oversees securities • Providing investor education to learn how fraud has been perpetrated in the past so that investors can identify it in future • Mandatory holding periods to prevent pump-and-dump schemes
Business	Failure	Crowdfund investments offer no guarantee of return	<ul style="list-style-type: none"> • Educating investors about portfolio diversification as a means to prevent total loss of investment(s)
Business	Anti-money laundering	Using businesses as a cover for illegal money transfers	<ul style="list-style-type: none"> • Placing caps on amounts that may be raised in specific time periods • A “cooling off period” between reaching the funding target and funds transfer to allow for further diligence by investors and regulators
Business	Sector risk	Crowdfunding has had the most traction in consumer products and extensions of popular brands or games	<ul style="list-style-type: none"> • Build on small successes in areas like science and energy • Raise small amounts of capital to show market interest and customer validation • Consider leveraging the crowd for only a small part of the overall capital raise to identify interest and de-risk the bigger investment
Business	Subsequent funding failure	Bringing on crowdfund investors creates a more complicated investor table that may deter subsequent investors	<ul style="list-style-type: none"> • Consider the use of a Special Purpose Vehicle (SPV) to group all crowdfund investors into one voting group to ease communication and voice • Offer to buy out crowdfund investors at subsequent rounds of financing at the current price
Investor	Investor liquidity and losses	Crowdfunded stocks are not liquid, businesses do fail and investor can lose their investments	<ul style="list-style-type: none"> • Investment limits for nonaccredited investors • Allowing for crowd vetting and crowd diligence to discuss the merits/risks of the offering in a public manner • Promote the creation of secondary markets after a 12-month holding period where shares may be traded based on supply and demand

Type	Risk	Rationale	Mitigation Tactic
Entrepreneur	Lack of issuer experience	Entrepreneurs do not always have all the experience needed to build, run, and raise capital for a business	<ul style="list-style-type: none"> • Create education programs about how to build a business • Create education programs about how to raise money from the crowd and follow through with a plan once funded • Requiring the participation of either a securities broker/dealer, an attorney or accountant
Regulatory	Regulatory and compliance risk	Regulatory bodies may resist or reject the argument that crowdfunding is an appropriate and effective method of financing early-stage companies	<ul style="list-style-type: none"> • Work with local governments prior to offering crowdfund investing • Engage with local regulatory and policy constituents to build crowdfunding frameworks
Industry	Market rejection	Investor community might not have an appetite for this new emerging asset class	<ul style="list-style-type: none"> • Leverage the media to share success stories of businesses that have been successful with crowdfunding investing and jobs that have been created • Share early financial engagement stories of investors who have backed crowdfunded companies and why • Offer crowdfund investments in tandem with more traditional investments to act as an honest broker

The protective measures suggested focus mainly on disclosure requirements, educational requirements for the funders and certain caps to be placed on investments of funders and project creators.

2.5.3 Failure to achieve production timetables and delivery promises

Some projects using the pre-purchase model of crowdfunding (rewards-based crowdfunding), find it difficult to deliver their obligations on time (Mollick, 2014:11-13). It has furthermore been determined that the delays have not necessarily been caused by fraud and that very few projects do not deliver. By conducting interviews, Mollick (2014:13) determined that complexities and unexpected events (such as manufacturing problems, the complexity of shipping, changes in scale, changes in scope and unanticipated certification issues) are better explanations of lack of performance. He determined that, compared to projects funded at their goal amount, projects funded at ten times their goal amount are half as likely to deliver at a given time (Mollick, 2014:13). The World Bank (2013:44) also indicated that the primary risk in rewards-based crowdfunding

is the fulfilment risk since funders sometimes struggle to differentiate “intention to produce” from “capability to produce”.

2.5.4 Money laundering

The risk of money laundering is not deemed greater by the World Bank in crowdfunding than in other investment systems. According to the World Bank (2013:45), the three largest international donations platforms (Kickstarter, Indiegogo and RocketHub) are fully compliant with international and USA anti-money laundering laws. In addition, electronic payment processors that are used by platforms also contain protection mechanisms against money laundering (World Bank, 2013:45).

2.5.5 Investor protection

Funders face a number of asymmetrical information problems because some information which is known to the project creator is unknown to the funder (Agrawal *et al.*, 2013:20; Schwartz, 2015a:631-632). Furthermore, the managers of a crowdfunding project (the “agents”) might act in their own interests as opposed to those of the investors (the “principals”) thereby resulting in agency costs (Schwartz, 2015a:633-634). Schwartz (2015a:662) argues that the unique characteristic of crowdfunding, which is making use of the wisdom of a diverse crowd of investors, can address uncertainty and information asymmetry. This is because “[d]iverse people will make different mistakes, which in the aggregate will encircle the truth” (Schwartz, 2015a:660). Herding might occur where the decisions of later funders are influenced by those early funders who relied on the decisions and characteristics of fellow funders (Belleflamme *et al.*, 2015:21). Schwartz (2015a:668-669) argues that herding might not be a fatal problem for crowdfunding because investors are independent from each other which consequently enhances the possibility that they will act independently from one another.

According to Pekmezovic and Walker (2016:393), a regulatory approach that addresses the needs of a crowd of diverse investors should be adopted since it is difficult to assess the nature of a particular investor. Schwartz (2015a:662) argues that the requirements in

the Crowdfund Act of the USA, that only successfully funded projects are allowed to get access to the funds¹² and that investors have the right to cancel a commitment¹³, specifically enhance the wisdom of the crowd effect. Information asymmetry and agency costs can furthermore be reduced by making use of online reputation (Schwartz, 2015a:669-677). Investors and project creators can link, for example, their crowdfunding campaign to their Facebook or other social network profile, which can act as a signal of a good project (Schwartz, 2015a:669,672,674). Digital monitoring, which allows the investor to use technology at a low cost to monitor the management of the company (project) (such as the monitoring of sales figures and having online meetings without having to incur expensive travel costs), will also reduce information asymmetry and agency costs (Schwartz, 2015a:679, 684). Being digital (using the Internet which distinguishes crowdfunding from other sources of financing such as venture capital and angel investors) therefore plays an important role in the regulation and self-regulation of crowdfunding.

Some crowdfunding platforms and/or projects warn the investors of the potential risks associated with funding a project. According to empirical results from a study conducted by Koch and Siering (2015:11), the descriptions on potential risks related to a project on the crowdfunding platform do not, however, influence the funding success of a project since they are neither valued nor do they have a negative influence.

2.5.6 Intellectual property protection

A project creator needs to disclose information about the project on the platform in order to attract funders and to keep them informed. Information also needs to be shared in order to benefit from the knowledge of the crowd, for example in testing and/or validating the market. This increases the risk that somebody else might imitate the project creator's idea and thereby infringe upon the project creator's intellectual property rights (Röthler & Wenzlaff, 2011:24).

¹² Title 15 U.S.C 77d-1(a)(7).

¹³ Title 15 U.S.C 77d-1(a)(7).

2.5.7 Tax evasion

Since crowdfunding is a relatively new concept, there is a risk of tax evasion, and the lack of policies and guidance on crowdfunding transactions also increase this risk. Also, since money laundering and fraud are some of the risks identified with crowdfunding, the risk of tax evasion is presumed.

The current SA income tax consequences are discussed in Chapter 6. Non-compliance with any of the existing tax provisions may lead to tax evasion. The risk of tax evasion lies *inter alia* in project creators not declaring income received from the funders as gross income. Furthermore deductions may be claimed by the project creators and funders which do not satisfy the “trade” requirement of the ITA, other requirements of section 11(a) and/or any other section of the ITA.

The risk of tax evasion can be reduced by reducing uncertainty pertaining to the tax implications of crowdfunding. This can be done through certain mandatory disclosure requirements (see Chapter 4) as well as by making people aware of the specific tax consequences of crowdfunding transactions.

2.6 CONCLUSION

Four crowdfunding models were identified in this chapter. These are donation-based crowdfunding, rewards-based crowdfunding, debt-based crowdfunding and equity-based crowdfunding. These models differ in flexibility and complexity, as well as in what the expected return is for the funding provided. It was furthermore determined (based on the results of the comparison of data reflected in Table 2 and Table 3) that the use of crowdfunding is increasing in South Africa.

Based on the benefits associated with crowdfunding, crowdfunding is an innovative means of gaining access to the funds of entrepreneurs. Luis *et al.* (2015:134) summarise the benefits of crowdfunding by stating that crowdfunding “promotes an environment of collective decision-making based on the technical and operational infrastructure of social

networks and peer-to-peer systems". Crowdfunding is therefore more than just a method of financing. It allows project creators to interact with the funders and to get feedback from them regarding the project. Most of the benefits associated with crowdfunding are benefits for the project creator while the funder mostly receives intrinsic benefits from providing funding.

The risks related to using crowdfunding may be linked or related to the problems of uncertainty, information asymmetry and/or agency costs. It is important that regulators address these risks for the crowdfunding market to be successful. Investors should be encouraged to invest in a crowdfunding project by providing the necessary protection against suffering losses.

The information obtained from two South African crowdfunding platforms was compared with the information obtained from the well-known and much-studied US-based crowdfunding platform, Kickstarter. Based on this basic comparison of the information obtained from the platforms, it was determined that crowdfunding in SA is similar to that of Kickstarter. This will however be confirmed and further investigated by means of further research conducted in this study. The research philosophy and research design are discussed in the next chapter.

CHAPTER 3: RESEARCH PHILOSOPHY AND RESEARCH DESIGN

3.1 INTRODUCTION

Research is a “systematic process of collecting, analysing and interpreting information ... in order to increase our understanding of a phenomenon about which we are interested or concerned” (Leedy & Ormrod, 2010:2). The main research objective of this study is to critically evaluate the taxation of crowdfunding transactions in South Africa in order to recommend an appropriate tax framework for crowdfunding in South Africa. The fundamental research question is to consider whether the current taxation provisions in South Africa are appropriate for the economic environment in the 21st century and, if not, what more optimal set of provisions might be adopted. In pursuit of the main research objective, the research design is applied within a certain research paradigm and research methodology which are discussed first, before the research process is explained.

3.2 RESEARCH PHILOSOPHY AND RESEARCH METHODOLOGY

The research philosophy that a researcher adopts, contains assumptions about the way in which the researcher views the world (Saunders, Lewis & Thornhill, 2009:108). While other researchers refers to paradigms, ontology and epistemology or research methodology, Creswell (2014:6) refers to the research philosophy in a single term as the “worldview” of the researcher.

The four research philosophies identified by Saunders *et al.* (2009:113-119) are positivism, realism, interpretivism and pragmatism, and each research philosophy has its own distinct ontology and epistemology. Ontology is concerned with the assumptions the researcher makes about the way in which the world works (what is reality and the nature of reality?) (Saunders *et al.*, 2009:110). Epistemology is concerned with what is acceptable knowledge to the researcher in a particular field of study (how do you know reality?) (Saunders *et al.*, 2009:112). The four research philosophies are summarised in Table 6.

Table 6: Comparison of four research philosophies in management research (Saunders *et al.*, 2009:119)

	Positivism	Realism	Interpretivism	Pragmatism
Ontology: the researcher's view of the nature of reality or being	External, objective and independent of social actors	Is objective. Exists independently of human thoughts and beliefs or knowledge of their existence (realism) but is interpreted through social conditioning (critical realism)	Socially constructed, subjective, may change, multiple	External, multiple, view chosen to best enable answering of research question
Epistemology: the researcher's view regarding what constitutes acceptable knowledge	Only observable phenomena can provide credible data and facts. Focus on causality and law like generalisations, reducing phenomena to simplest elements	Observable phenomena provide credible data, facts. Insufficient data means inaccuracies in sensations (direct realism). Alternatively, phenomena create sensations which are open to misinterpretation (critical realism). Focus on explaining within a context or contexts.	Subjective meanings and social phenomena. Focus upon the details of situation, a reality behind these details, subjective meanings motivating actions	Either or both observable phenomena and subjective meanings can provide knowledge depending upon the research question. Focus on practical applied research, integrating different perspectives to help interpret the data
Axiology: the researcher's view of the role of values in research	Research is undertaken in a value-free way, the researcher is independent of the data and maintains an objective stance	Research is value-laden; the researcher is biased by world views, cultural experiences and upbringing. These will impact on the research	Research is value bound, the researcher is part of what is being researched, cannot be separated and so will be subjective	Values play a large role in interpreting results, the researcher adopting both objective and subjective points of view
Data collection techniques most often used	Highly structured, large samples, measurement, quantitative, but can use qualitative	Method chosen must fit the subject matter, quantitative or qualitative	Small samples, in-depth investigations, qualitative	Mixed or multiple method designs, quantitative and qualitative

According to McKerchar (2008:5), the field of taxation is studied through different disciplinary lenses such as law, accounting, economics, political science, psychology and philosophy and is not a discipline in its own right. Creswell (2014:6) argues that a discipline's orientations, the student's advisor's/mentor's inclinations and past research experience influence the worldview of the researcher. Different results might therefore arise from a single study of taxation, depending on the disciplinary lens and worldview of the researcher and it is therefore important to understand the worldview of the researcher.

Since crowdfunding consists of funders (individuals), project creators and regulators, various disciplines such as law, political science, psychology and philosophy influence crowdfunding. According to Creswell (2003:12), "pragmatists agree that research always occurs in social, historical, political, and other contexts. In this way, mixed methods studies may include a postmodern turn, a theoretical lens that is reflective of social justice and political aims". The worldview of pragmatism is orientated to what works in practice and values both objective and subjective knowledge (Cresswell & Plano Clark, 2011:41). In this worldview, the research question is the most important determinant of the epistemology, ontology and axiology (Saunders *et al.*, 2009:109). This study is grounded in the pragmatic philosophical paradigm. With a pragmatic worldview, the focus is on the consequences of research (the research question is of primary importance) rather than on the methods used.

3.3 RESEARCH DESIGN

Harrits (2011:151) argues that a mixed method research design does not necessarily constitute a single research paradigm but is founded within different paradigms. Given the nature of the research problem and the fact that the research on crowdfunding is still in its infancy (especially from a South African viewpoint), the broad research design of this study is a mixed method research design, so as to gather as much research data, from as many different sources, as possible. According to Creswell (2014:4):

Mixed methods research is an approach to inquiry involving collecting both quantitative and qualitative data, integrating the two forms of data, and using distinct

designs that may involve philosophical assumptions and theoretical frameworks. The core assumption of this form of inquiry is that the combination of qualitative and quantitative approaches provides a more complete understanding of a research problem than either approach alone.

The mixed method design approach is seen as a new methodology that originated around the late 1980s and early 1990s (Creswell, 2014:217; Teddlie & Tashakkori, 2009:7). The mixed method approach is sometimes referred to as integrated, synthesised, quantitative and qualitative or multimethod approaches (Creswell, 2014:217).

The advantage of using a mixed method design is that it provides more evidence of the research problem than either quantitative or qualitative research alone (Creswell, 2014:215). It assists in answering questions that cannot be answered by using a single approach (Cresswell & Plano Clark, 2011:12). With the identified lack of studies on crowdfunding from a South African viewpoint as well as the limited studies relating to the tax consequences of crowdfunding globally, it is submitted that a combination of qualitative and quantitative approaches will provide a more complete understanding of crowdfunding to address the research problem.

In a mixed method research design, the researcher:

- collects and analyses persuasively and rigorously both qualitative and quantitative data (based on research questions);
- mixes (or integrates or links) the two forms of data concurrently by combining them (or merging them), sequentially by having one build on the other, or embedding one within the other;
- gives priority to one or to both forms of data (in terms of what the research emphasises);
- uses these procedures in a single study or in multiple phases of a program of study;
- frames these procedures within philosophical worldviews and theoretical lenses; and
- combines the procedures into specific research designs that direct the plan for conducting the study (Cresswell & Plano Clark, 2011:5).

There are three basic mixed method designs. In the convergent parallel mixed method design, quantitative and qualitative data are collected and analysed separately. The results of the two data sets are then compared to confirm or refute each other (Creswell, 2014:219). Quantitative data are collected and analysed in the first phase of an explanatory sequential mixed method design (Creswell, 2014:219). The results from the first phase are then used to plan the second qualitative phase. In the exploratory sequential mixed method design, qualitative data are explored and analysed in the first phase (Creswell, 2014:226). The second phase consists of the collection of quantitative data and builds on the first phase. The purpose of the exploratory sequential mixed method design is “to develop better measurements with specific samples of populations (in qualitative phase) and to see if data from a few individuals can be generalised to a large sample of a population (in quantitative phase)” (Creswell, 2014:226). The three basic mixed method designs are illustrated in the figure below.

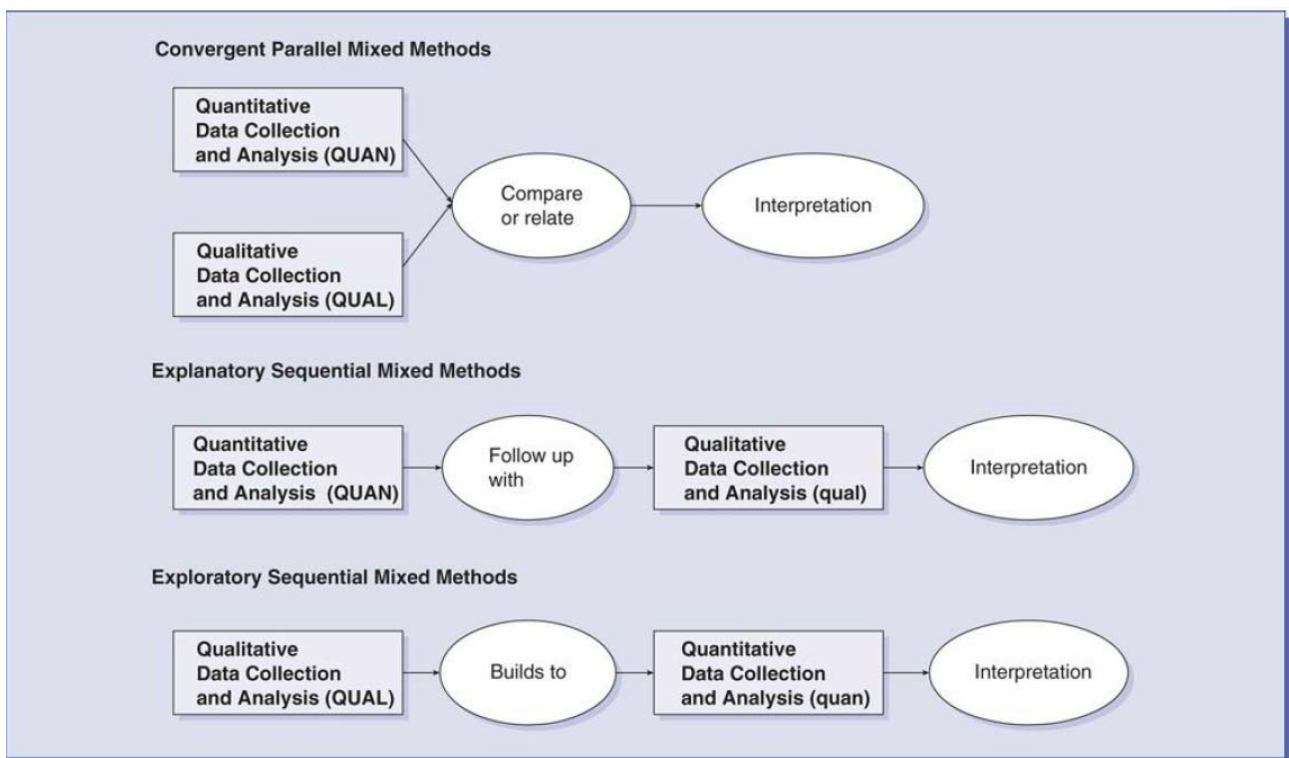


Figure 6: Three basic mixed method designs (Creswell, 2014:218)

An exploratory sequential mixed method research design is followed in this study. Since a mixed method design comprises both quantitative and qualitative data collection, a

challenge in using mixed methods is that it requires the researcher to be familiar with both quantitative and qualitative data collection. This could require extensive time and resources (Cresswell & Plano Clark, 2011:14). In this exploratory sequential design study, a combination of qualitative and quantitative research data is used. Each plays an important role in addressing the research problem. However, since the main objective of the study is to critically evaluate the taxation of crowdfunding transactions in SA in order to recommend an appropriate tax legislation amendment, the qualitative phase of the research design is the first phase of the research, followed by the second, quantitative, phase being guided by the findings of the first phase.

3.3.1 Qualitative first phase of the research design

This research commenced with the first phase of the study which was conducted by means of the collection and analysis of qualitative secondary data gained from scientific database analysis and library research. This included a study of appropriate sources containing authoritative publications, books, journals, the Internet and official documents such as policies to gather information on the various crowdfunding models, tax and other regulations (such as the Companies Act 2008) applicable to crowdfunding that might have an effect on the tax implications. This established a global theoretical platform for the study. In this phase, crowdfunding, as well as the different models of crowdfunding, is explained and defined. The body of available literature on crowdfunding consists mainly of studies conducted internationally, since no significant study from a South African viewpoint could be identified. Furthermore, studies already conducted globally were investigated in order to determine why entrepreneurs and investors make use of crowdfunding. It is important to determine this, as Burtch, Ghose and Wattal (2013:3) argue that the behaviour of funders is an important aspect that must be considered in formulating policies and regulations relating to crowdfunding. According to Lieu (2019), the USA, UK and NZ are prominent for their proactive response to equity crowdfunding. Since the research on crowdfunding is expanding rapidly and countries such as the USA, UK, Australia and New Zealand have already started to issue guidelines and regulations regarding crowdfunding, such existing and new research were explored and analysed by legal interpretation and comparative assessment.

A qualitative research approach, however, does not consist only of documentary sources but also of the perspectives and beliefs of other role-players (Joubert, Hartell & Lombard, 2016:110). According to Mouton (2001:180), the main sources of error associated with a literature review are “selectivity in the sources; unfair treatment of authors; misunderstanding the source; selective interpretation to suit one’s own viewpoint; poor organisation and integration of review”. Interviews were conducted with relevant role-players in crowdfunding transactions in order to gain insight into the crowdfunding industry from a South African viewpoint. The interviews were conducted with two of the founders of the main South African crowdfunding platforms (the founder of Thundafund, BackaBuddy and Uprise.Africa – the first equity crowdfunding platform in SA – and the founder of Jumpstarter). Data was furthermore obtained through online observations and monitoring of these crowdfunding platforms. This data obtained from South African platforms was then compared to the findings from international studies in order to determine whether the dynamics of crowdfunding in South Africa are similar to those internationally.

3.3.2 Quantitative second phase of the research design

The second phase consisted of the collection of quantitative data and built on the first phase. The purpose of this phase of the research design is to determine the relevance of the findings of the first phase to a broader sample in a South African context. The findings obtained from the first phase of the study (literature study and interviews with the founders of the platforms), were used to develop a survey instrument (a questionnaire) which was sent to a population of funders and project creators to determine whether the qualitative findings were supported by a broader population in South Africa. An electronic link to the designed questionnaire was made available by the three platforms, and platform users were invited to voluntarily complete the questionnaire. Since the link was an open call to anybody to participate, the size of the population could not be determined and included every funder, potential funder, project owner or potential project owner. The link to the questionnaire was also made available and shared publically on the Facebook profile of the researcher.

The information gathered through the survey was compared with the findings obtained in the first phase of this study. The comparison was performed with regard to the crowdfunding model used, the motivations for investing and using crowdfunding, the risks and benefits associated with crowdfunding, and so on.

This comparison is important in order to determine if crowdfunding in South Africa is comparable to crowdfunding internationally. This is important since the literature studied was based on international crowdfunding platforms (due to the lack of studies from a South African viewpoint). By determining that crowdfunding abroad is similar to crowdfunding in South Africa, specific rules and regulations relating to crowdfunding adopted globally, might be relevant to the crowdfunding environment in South Africa. The extent to which it might applied, also needed to be determined.

Information gathered through the literature review, interviews and questionnaires was evaluated in order to suggest a distinct policy framework for the South African crowdfunding industry that is not counterproductive, encourages SME growth and assists in remaining competitive in the global market.

3.3.3 Measuring instruments

Document analysis of appropriate sources containing authoritative publications, books, journals, the Internet and related literature was conducted. Personal interviews were conducted with the founders of four crowdfunding projects. The interviews were used to find other possible attributes that might further qualify the problem statement.

Internal validity is the extent to which a piece of evidence supports a claim about cause and effect within the context of a particular study, while external validity relates to how applicable the results are to the real world. Since a mixed method approach was followed in this study, the interview questions were prepared after an in-depth literature review that provided a thorough understanding of crowdfunding internationally. The interview questions were prepared with the purpose of addressing the research objectives, and to obtain answers to the stated research questions. The interviews were conducted with

more than one participant. The results obtained from the interviews were compared to existing literature, to the results of the various interviews, and to data already available on the online platforms in order to validate it and to identify discrepancies. Furthermore, Cronbach's alpha was used as a measure to assess internal consistency of the questions that formed part of the questionnaires (UCLA: Statistical Consulting Group, n.d.). A strong measure of internal consistency would provide evidence that the results from the questionnaires possess a solid theoretical grounding. Support for the constructs of the questionnaire through the use of principal components analysis provided assurance that the survey constituted an instrument possessing content validity.

The outcomes of the document analysis and the interviews were used to design the questionnaire. The questionnaire (consisting of closed as well as open-ended questions) was used to address the main and secondary research objectives and the research questions through the responses received from the research respondents. Due to the nature of the research topics, the respondents in this research project could base their responses on their own perceptions and/or working or personal experiences relating to crowdfunding in general.

3.3.4 Statistical analysis

All the personal interviews conducted with research participants were recorded on a digital voice recording device and saved as Windows media audio files. Content analysis was done on the verbatim transcriptions of the interviews conducted. The results of the literature review and interviews were then integrated in order to design a questionnaire for the purpose of this research.

The survey instrument (questionnaire) was designed by using the automation software EvaSys. Pilot testing was done on the questionnaire to determine the validity thereof. The data collected with the questionnaire was analysed. Statistical ratios and data relationships were calculated for each of the questions in the questionnaire.

3.3.5 Ethical considerations

This study was submitted for and granted ethical clearance. Specific ethical clearance was obtained for the performance of interviews with crowdfunding platforms as well as for the questionnaires which were made available on the platforms for completion by funders. A letter of consent was prepared for and signed by founders with whom the interviews were conducted. The survey questionnaire was completed anonymously by the participants.

3.4 CONCLUSION

The research philosophy and research design have been explained in this chapter. Four research philosophies were identified, each with its own distinct ontology, epistemology and axiology. Although several research philosophies can be applied in the field of taxation, the researcher followed a pragmatic worldview in this study. This worldview is followed since crowdfunding is influenced by various disciplines, and the taxation implications of crowdfunding is therefore also influenced by those various disciplines.

Due to the limited available research on crowdfunding from a South African perspective, an exploratory mixed method research approach was followed in this study. This design was deemed to be appropriate because of the mentioned limited availability of South African research on crowdfunding. By using various methods, data was gained from various sources.

The international developments of crowdfunding in the US, UK, Australia and New Zealand are discussed in the next chapter.

CHAPTER 4: INTERNATIONAL DEVELOPMENTS OF CROWDFUNDING

4.1 INTRODUCTION

The World Bank (2013:56-63) submits that an entrepreneurial culture, economic regulation, community engagement and technology are the key elements of a crowdfunding system. They further suggest that organisations and governments of countries should evaluate these elements to determine their country's readiness for equity and debt-based crowdfunding (World Bank, 2013:56). The four elements and strategies recommended by the World Bank are summarised in Figure 8 below.

Specific strategies to drive crowdfunding	
<p style="text-align: center;">Economic</p> <ul style="list-style-type: none"> • Craft exceptions to securities regulations that allow easy registration for equity and the debt crowdfund offerings • Strategically tie crowdfunding to patriotic and cultural messages • Form a crowdfunding market alliance 	<p style="text-align: center;">Social</p> <ul style="list-style-type: none"> • Harness top social media experts/bloggers/ tastemakers to communicate with local audiences and with diaspora audiences • Hold media and educational events to build awareness and understanding • Hold regular crowdfunding events with trusted third parties to teach successful techniques
<p style="text-align: center;">Technology</p> <ul style="list-style-type: none"> • Where appropriate, apply lessons learned from developed world • Consider buy, build or white label • Determine gaps in existing technology for online financial transactions 	<p style="text-align: center;">Cultural</p> <ul style="list-style-type: none"> • Leverage existing incubator/accelerator/ structured co-working spaces as hubs for innovation in funding • Foster professional investor & consumer confidence in crowdfunding through education and communication • Encourage the participation of women and girls

Figure 7: Government, NGO and private sector recommendations (World Bank, 2013:58)

These four elements identified by the World Bank are similar to the crowdfunding participants identified in Chapter 1 (see Figure 1), being the project creators (cultural), the

funders (social), the regulation of the government (economic), and the platform (technology). The report furthermore provides a self-assessment questionnaire (based on these four elements) whereby the readiness of a country for crowdfunding can be measured (World Bank, 2013:66-72). The questionnaire measures, for example, the extent of technology development in the country, the speed of the Internet, the engagement of the population with social media, the culture of entrepreneurship, the level of regulation and complexity thereof involved in starting a business, the availability of capital, and so forth.

It is, however, submitted by the researcher, that, with the rapid expansion of the Internet (as seen in Table 1 in Chapter 1) and social media as well as the removal of barriers between countries, crowdfunding will continue to exist regardless of whether or not the government deems it to be ready and of value to the economy. The growth in crowdfunding has been seen in Tables 2 and 3 (in Chapter 2), with the increase in crowdfunding numbers between the years exemplified. Not taking note of this will result in an unregulated industry that will continue to exist, with a concomitant outflow of money invested in countries other than the country of origin of the funder.

Internationally, some governments have already implemented regulations and/or tax incentives specifically applicable to some crowdfunding models. Regulations and tax incentives have mainly been implemented for the debt and equity models, whereas existing tax laws are used for the donation and rewards models. The tax laws applicable to the four models of crowdfunding in the USA, UK, Australia and New Zealand are discussed in this chapter. Related specific regulations that have been implemented by these countries for equity and debt-based crowdfunding are also discussed. The USA was the first country to commence the process of amending their Securities and Exchange Commission's (SEC) Regulations in order to allow equity crowdfunding.

4.2 DONATION AND REWARDS MODELS

The tax treatment of crowdfunding transactions in the donation and rewards models are discussed below. These two models are discussed since, according to Belleflamme *et al.*, (2015:12), it can sometimes be difficult to distinguish between the donation model and the rewards model. This is because simply mentioning the name of the funder can also be seen as a reward, which might then rather be classified as rewards-based crowdfunding.

No specific tax legislation provisions dealing with these models of crowdfunding could be found in any of the countries that form part of this study. The tax treatment of these types of crowdfunding transactions, is therefore determined by applying existing tax rules.

4.2.1 United States of America

The USA is seen as the market leader in crowdfunding (De Beer, 2014:20). The Internal Revenue Service (IRS) is responsible for collecting and administering the federal tax laws contained in the Internal Revenue Code (IRC)¹⁴ (USA, 1986). The IRC does not contain specific provisions dealing with crowdfunding transactions (Metrejean & McKay, 2015:45-46). The tax treatment of crowdfunding transactions is therefore determined by applying normal tax rules which depend on the crowdfunding model used.

The project creator will be exempt from tax if it is a tax exempt entity (IRC §501-515) or if it contracts with an existing tax exempt entity in order to use its tax exempt status (Battista, 2015:155). If the project creator is not exempt from tax, the tax implications, as discussed below, will apply.

4.2.1.1 Donations received

Taxes are paid on gross income received as defined in IRC §61(a). Gross income means all income from whatever source derived, including (but not limited to) compensation for

¹⁴ <https://www.irs.gov/about-irs>

services (including fees, commissions, fringe benefits, and similar items), gross income derived from business, and gains derived from dealings in property.

IRC §102(a) states that gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. If the contribution is classified as a gift in terms of IRC §102(a), the contribution will not be taxed. A court case frequently cited, *Commissioner v. Glenshaw Glass Co*, 348 U.S., provides that income is “undeniable accessions to wealth, ...over which the taxpayers have complete dominion” (Supreme Court of the United States, 1955). This broad definition will therefore result in some crowdfunding contributions being taxable, depending on the type of crowdfunding transaction.

The IRS issued Information Letter 2016-0036 indicating that:

...crowdfunding revenues are generally included in income if they are not 1) loans that must be repaid, 2) capital contributed to an entity in exchange for an equity interest in the entity, or 3) gifts made out of detached generosity and without any “quid pro quo.” However, a voluntary transfer without a “quid pro quo” is not necessarily a gift for federal income tax purposes. In addition, crowdfunding revenues must generally be included in income to the extent they are received for services rendered or are gains from the sale of property (Department of Treasury Internal Revenue Service, 2016).

As stated in the Information Letter 2016-0036 above, amounts received from debt-based crowdfunding will not be taxed and will be further discussed in section 4.3.1. A corporation also should not include amounts received from funders in gross income if the amounts were for the capital account of the corporation (IRC §118). The Supreme Court concluded in *United States v. Chicago, Burlington & Quincy Railroad Company*, 412 U.S. 401, that to qualify as a non-shareholder contribution to capital, the following five factors need to be met: the asset must become a permanent part of the transferee's working capital structure; it may not be compensation for the transferee's services; it must be bargained for; it must benefit the transferee commensurately with its value; and it will ordinarily be used to produce additional income (Supreme Court of the United States, 1973:401).

If amounts were received for something in return, such as for a product or services rendered, such amounts will be taxed. Dietz (2013:295) studied the information provided to project creators and funders on the USA platform, Kickstarter. He determined that it is sometimes difficult to differentiate between gifts and sales in the context of the platform's crowdfunding model. The crowdfunding model used by Kickstarter is a hybrid model consisting of donations and/or rewards (Dietz, 2013:294). Creators can receive taxable contributions (if seen as normal sales transactions) and/or contributions which are considered to be non-taxable gifts (Dietz, 2013:294). If it is not a gift, the contribution received will not qualify for the gift exclusion provided for in IRC §102(a).

The following principles were laid down by the courts in the USA to determine whether or not an amount is a gift:

- The mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift (*Old Colony Trust Co. v Commissioner, 279 US: 716, 730*).
- It is not a gift if the payment proceeds are primarily from the “constraining force of any moral or legal duty” (*Bogardus v Commissioner, 302 US 41*).
- It is not a gift if the payment proceeds are primarily from the “incentive of an anticipated benefit” of an economic nature (*Bogardus v Commissioner, 302 US 41*).
- “Where the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it” (*Robertson v United States, 343 US 711, 714*).
- A gift is made “out of affection, respect, admiration, charity or like impulses” (*Robertson v United States, 343 US 714*).
- A gift is proceeds from a “detached and disinterested generosity” (*Commissioner v LoBue, 351 US 243, 246*).
- “What controls is the intention with which payment, however voluntary, has been made” (*Bogardus v Commissioner, 302 US 34, 45*).
- “A *claim* that it is a gift presents the sole and simple question whether its designation as such is genuine or fictitious – that is to say, whether, though *called* a gift, it is in *reality* compensation” (*Bogardus v Commissioner, 302 US 40*).

The government of the USA wanted to promulgate a “test” with fixed rules in order to determine whether proceeds qualify as a “gift” or not. In *Commissioner vs Duberstein* the

court confirmed the above principles of classification and rejected the government's proposed "test". It was submitted that "the 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 determination" (Court of the United States, 1959:287). The principles laid down above, will therefore be determinative of whether a donation is a gift and therefore not subject to tax.

4.2.1.2 Donations made by the donor

A deduction is available in IRS §170 for donations made to a qualified charitable recipient. The IRS compiled a two-part test in Revenue Rule 67-246 that should be followed to determine whether or not a part of a "dual payment" is deductible. The part of a gift or a donation that will be deductible is only the difference between the payment and the fair market value of the consideration received in the form of privileges and other benefits. This excess amount will furthermore only be deductible if it was made with the intention of making a gift (Internal Revenue Service, 1967:2). These principles were also referred to in *U.S. Reports: United States v. American Bar Endowment*, 477 U.S. 105 (Supreme Court of the United States, 1986:106).

If a donation is therefore made by a funder and a reward is received in return from the project creator, the funder will only be able to claim a deduction for the donation made based on the difference between the fair market value of the gift and the amount of the donation made. The taxpayer will furthermore have to prove that the intention of the donation was that of making a gift. It will apply similarly to rewards-based crowdfunding.

In an equity crowdfunding model, IRC §3519(a) determines that no gain or loss will be recognised for the funder if property is transferred to a corporation solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control as defined in section 368(c) of IRC. The funder will, however, have to recognise a gain (not a loss) to the extent of the fair market value of the property received if the funder receives rewards from the corporation in addition to the shareholding IRC §351(b).

IRC §2501 imposes a gift tax on an annual basis on all gratuitous transfers of property made by the donor. The taxable gift is determined by reducing the gross value of the gift by available deductions and exclusions (IRC §2501).

Contributions made to crowdfunding projects by the funders will be deductible if the funder can prove that they form part of the funder's trade or business as discussed below. If the donation is made simply as an investor and not as part of their trade or business, no deduction will be available (Levine & Segev, 2017:95).

4.2.1.3 General expenditure

Expenses are deductible in terms of IRC §162 if the crowdfunding activity is a trade or business (Cornell Law School, n.d.). IRC §183 limits the deductions to the gross income if it is an activity of an individual or a small business corporation which has not been engaged for profit. This provision prohibits the creation of an assessed loss and is similar to the provisions of section 20A in the ITA. Similar to the provision in section 20A of the ITA, the IRS issued a regulation containing nine factors which are generally considered to determine if an activity is engaged in for profit or not (Gard, 2013).

Contributions made to crowdfunding projects by a funder will be deductible if the funder can prove that they form part of the funder's trade or business. This might be where a donation is made for marketing purposes.

Certain expenses might be deductible by the project creator against such income if the crowdfunding income is included in gross income. The initial costs incurred in starting a business can, at the election of the taxpayer, either be capitalised or claimed as a deduction. Similar to section 11A of the ITA, which allows a deduction of pre-trade expenditure in the year that a trade commences, the expenses are only deductible in the year that an active business is carried on (IRC §195). If a deduction is elected, the deduction is limited to \$5 000 reduced by the amount by which such start-up expenditures exceed \$50 000. The remainder of such expenditure is allowed over a 180-month period beginning with the month in which the active trade or business starts (IRC §195).

Corporations are allowed to deduct organisational expenditure (expenditure incurred in the creation of the corporation) by applying the same limits as stated above (IRC §248). In order for a crowdfunding project to claim start-up expenditure as a deduction, it will have to be determined whether or not an active business is carried on. Similar to SA, case law of the USA needs to be considered to determine what an active business is.

4.2.2 United Kingdom

Crowdfunding is supported and encouraged by the government of the UK. This is evident from the policy changes made by the government since 2014. The Income Tax Act 2007 (United Kingdom, 2007) provides the main provisions about income tax and is administered by Her Majesty's Revenue and Customs (HMRC)¹⁵. However, other acts (also administered by the HMRC) such as the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) (United Kingdom, 2005) and the Income Tax (Earnings and Pension) Act 2003 (ITEPA) (United Kingdom, 2003) contain provisions dealing with specific types of transactions. The relevant sections from these acts, dealing with crowdfunding, are discussed below.

4.2.2.1 Donations received

Income is charged on trading profits in the hands of the person who receives the profits or who is entitled to the profits¹⁶. A number of court cases dealt with whether or not a voluntary receipt was a trading receipt and therefore taxable. It was held in *Simpson v Reynolds*¹⁷ (and later confirmed in other cases such as *Walker v Carnaby*) that it is not a trading receipt if the gift was wholly unexpected and unsolicited, if it was made after the business connection had ceased, if it was in recognition for past services rendered and not because of inadequate remuneration for those services rendered, if it was made as consolation for the fact that the services are no longer to be performed, or if there is no

¹⁵ <https://www.gov.uk/government/organisations/hm-revenue-customs/about>

¹⁶ Income Tax (Trading and Other Income) Act Pt 2 c.1 s. 5 and s. 8.

¹⁷ *Simpson v Reynolds & Co (Insurances) Ltd (1975)*; *Walker v Carnaby, Harrower, Barham & Pykett [1970]*.

suggestion of a future business connection. In *McGowan v Brown*¹⁸ the court found that, if a gift was earned (i.e., work was carried out so there is a legal or moral obligation to pay), it is taxable even though the payment was voluntary. If the gift was deserved it is not taxable.

It was held in *Falkirk Ice Rink*¹⁹ that a donation made to the club was a trading receipt since it was used to supplement its trading revenue and to enable the company to continue to trade. In *Murray v Goodhews*²⁰ it was emphasised that the motive of the payer is not the determining factor to determine whether or not a receipt should be taxed but rather that of the recipient.

The fact that a payment is entirely voluntary is therefore insufficient to exempt it from tax in the hands of the recipient when it is received in a business capacity. A voluntary receipt received in a personal capacity would normally not be subject to income or corporations tax, in contrast with a receipt used to finance business activities. Based on this, it appears that a project creator that receives a voluntary donation from the donor, will be taxed on such receipt since the receipt is used to finance business activities.

A recent court case dealt specifically with the Value-Added Tax (VAT) treatment of a crowdfunding campaign on the crowdfunding platform, Kickstarter in the UK²¹. The issue was whether the funds were subject to VAT upon receipt of payment. It firstly had to be determined whether the sums received represented a prepayment of consideration for supplies of services or consideration for supplies of face value vouchers (FVVs); and, secondly, if consideration for a supply of FVVs, whether these were “single purpose vouchers” within Schedule 10A of the Value-Added Tax Act 1994 (United Kingdom, 1994). It was held that the payments were not prepayments since it was unclear at the time of the pledges what (if anything) would be supplied. Whether something will be supplied depends on whether or not the funding goal is achieved. It was held that the backers were

¹⁸ *McGowan v Brown* [1977].

¹⁹ *CIR v Falkirk Ice Rink Ltd* [1975] STC 434.

²⁰ *Murray v Goodhews* [1977].

²¹ *Lunar Missions Ltd* [2018] TC 06286.

supplied with single purpose vouchers that granted them the right to receive one type of service. Accordingly, the consideration was taxable for VAT purposes at the time the vouchers were issued.

Although VAT is excluded from the scope of this study, it might be used to argue that, with rewards-based crowdfunding, there is not a sale (and hence no amount is received or accrued in respect of sales made) until the funding goal is achieved for income tax purposes. This does not imply, however, that the amount will not be taxable as is evident from the court cases discussed above.

In general, a company is not allowed to claim a deduction for expenses incurred in providing entertainment or gifts in connection with the trade²². An exception is where the gift is of an item which it is the trader's trade to provide, and the item is given away in the ordinary course of the trade in order to advertise to the public generally²³. If the gift incorporates a conspicuous advertisement for the trader it will also be deductible as long as it is not food, drink, tobacco or a token or voucher exchangeable for goods. If something else is given as a gift, the cost of the gift to the company, together with any other gifts (except food, drink, tobacco or a token or voucher exchangeable for goods) given to the same person in the same basis period, should also not exceed £50²⁴.

4.2.2.2 Donations made by the donor

The donor might be entitled to gift aid relief if the donation was made to a charity which is a qualifying donation²⁵. One of the requirements for a donation to be a qualifying donation is that there should not be benefits associated with the gift, or if there are benefits associated with the gift, the restrictions on those benefits should not be breached²⁶.

²² Income Tax (Trading and Other Income) Act 2005 Pt 2 c.4 s.45.

²³ Income Tax (Trading and Other Income) Act 2005 Pt 2 c.4 s.47(2).

²⁴ Income Tax (Trading and Other Income) Act 2005 Pt 2 c.4 s.47(3).

²⁵ Income Tax Act 2007 Pt 8 c.2 s.414.

²⁶ Income Tax Act 2007 Pt 8 c.2 s.416(7).

The restrictions on benefits associated with a gift are breached if one of the following conditions is met:

1. The total value of the benefits associated with the gift exceeds the variable limit of 25% of the amount of the gift, if the amount of the gift is £100 or less; £25, if the amount of the gift is more than £100 but not more than £1,000; 5% of the amount of the gift, if the amount of the gift is more than £1,000.
2. The sum of the total value of the benefits associated with the gift, and the total value of the benefits (if any) associated with each relevant prior gift, is more than £2,500.

A donation made under Gift Aid is treated as if it has been received by the charity after the deduction of an amount of tax calculated at a rate of 20%. The charity is then able to reclaim the basic rate tax credit. If an individual taxpayer makes a donation of £100, the charity can reclaim an additional £25 ($£100 \times 20/80$). The donor who is a basic rate taxpayer will receive no further tax relief as a result of making a donation. If the donor is a higher and/or additional rate taxpayer, the taxpayer will be able to claim tax relief on the difference between the higher/additional rate tax and basic rate on the grossed up donation. If an individual taxpayer makes a donation of £100, for example, the charity can reclaim an additional £25, giving a grossed-up donation of £125 received by the charity. Where the taxpayer is a 40%-taxpayer, £25 ($40\% - 20\% \times £125$) can be reclaimed by the taxpayer, giving a net donation cost of £75. The taxpayer would have paid tax of £50 ($£125 \times 40\%$), but “withheld” £25 (by paying only £100 to the charity and the charity being able to receive the gross amount of £125 as explained above by using the Gift Aid). The taxpayer then further claims the difference of £25 ($40\% - 20\% \times £125$) personal tax relief from HMRC. This results in £0 ($£50 - £25 - £25$) overall net position with regard to taxes paid for the taxpayer (Gnessen, 2018; Stewardship, 2015:1-13).

If the funding provided does not qualify as a donation, the donor might be allowed to claim the amount as a deduction for a business expense. This is if it can be proved that the expenses were incurred wholly and exclusively for the purposes of the trade as discussed below.

4.2.2.3 General expenditure

In calculating the profits of a trade, deductions are allowed for expenses incurred wholly and exclusively for the purposes of the trade and for losses connected with or arising out of the trade²⁷. No deduction is allowed for expenses of a capital nature²⁸.

Pre-trade expenditure is deductible in the year that trading commences if it was incurred for purposes of trade not more than seven years before the carrying on of that trade²⁹.

4.2.3 Australia

The Income Tax Assessment Act 1997 (ITAA97) (Australian Government, 1997) does not contain specific provisions dealing with crowdfunding. The ITAA97 is administered by the Australian Tax Office (ATO).

4.2.3.1 Donations received

Income is taxed if it is “assessable income”³⁰. The assessable income includes amounts received from ordinary income and some amounts that are not ordinary income (referred to as statutory income)³¹. If an amount is not income, it might be subject to capital gains tax (Martin & O’Connell, 2018:19). The word “income” is not defined in the ITAA97 and case law principles need to be referred to.

A gift received is normally not taxable since it is of a capital nature and therefore not assessable income³². It was held by the courts that the motives of the donor do not

²⁷ Income Tax (Trading and Other Income) Act 2005 Pt 2 c.5 s.34.

²⁸ Income Tax (Trading and Other Income) Act 2005 Pt 2 c.5 s.33.

²⁹ Income Tax (Trading and Other Income) Act 2005 Pt 2 c.5 s.57.

³⁰ Section 6-1 of the Income Tax Assessment Act 1997.

³¹ Sections 6-5 and 6-10 of the Income Tax Assessment Act 1997.

³²<https://www.ato.gov.au/Business/Income-and-deductions-for-business/Assessable-income/What-income-to-exclude/>

determine whether a gratuitous payment is income in the hands of the recipient. The character of the receipt in the hands of the recipient needs to be determined. It does not depend on whether it was a payment or provision that the payer or provider was lawfully obliged to make. It was further held that, if there is a nexus between the gift and the taxpayer's activities, it will be income if the gift is in a relevant sense a product of the activities³³. It is therefore possible for a donation to be assessable income if it relates and can be linked to the business activities of the person that received the donation.

It was held in *Federal Commissioner of Taxation v Montgomery*³⁴ that, "income is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on a business are mostly (but not always) income". According to Martin and O'Connell (2018:18), the principles laid down by the courts to determine whether or not an amount is income, may be summarised as follows: income is a gain; income is a flow that comes in to a taxpayer; there is a difference between income and capital and there must be an income-earning activity such as the provision of a service or the carrying on of a business. These principles are very similar to those applied in ITA of South Africa.

"Business" as defined includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee³⁵. The court held in the case of *Ferguson*³⁶ that the following factors are relevant to assess whether a taxpayer was carrying on a business:

- The nature of the activities, particularly whether they have the purpose of profit-making.
- Repetition and regularity of the activities.
- Organisation of activities in a business-like manner, the keeping of books, records and the use of system.

³³ *Scott v Federal Commissioner of Taxation* (1966) 117 CLR 527; *Hayes v Federal Commissioner of Taxation* (1956) 96 CLR 55, 56.

³⁴ *Federal Commissioner of Taxation v Montgomery* (1999) 198 CLR 639.

³⁵ Section 995-1 of the Income Tax Assessment Act 1997.

³⁶ *Ferguson v Federal Commissioner of Taxation* 79 ATC 4264 – 4265.

- The volume of his operations and the amount of capital employed by him may be significant.

These principles were confirmed in the case of *Woods*³⁷. The ATO also lists these factors on their website as characteristics of a business. Examples of factors that could indicate that the activity is planned, organised and carried out in a business-like manner are stated as: keeping business records and account books, having a separate business bank account, operating from business premises, having licenses or qualifications and having a registered business name³⁸. It follows that, if the project is therefore carried on in a business-like manner with the expectation of making a profit, the amounts received will be assessable income.

4.2.3.2 *Donations made by the donor*

Funds contributed by an individual who is not carrying on a business are not deductible. The contributor might qualify for a deduction if the donation is made to a Deductible Gift Recipient (DGR). There are different rules for claiming a tax deduction depending on whether the donation is a gift or a contribution. The ATO provides the following examples in order to distinguish between a gift and a contribution:

- A donor does not receive material benefit in return for their gift (for example, a donor puts \$5 in a collection box).
- A donor does receive a material benefit in return for their contribution (for example, a donor purchases a ticket to a fundraising dinner).

The deduction for a gift can be claimed by any taxpayer (individual or organisation) that makes the gift. If a contribution is made, the deduction can only be claimed if it is made by an individual taxpayer and in respect of an eligible fundraising event³⁹. If the contribution or gift is money, the amount of the deduction is the amount of money⁴⁰. However, if the

³⁷ *Woods v Deputy Commissioners of Taxation [1999] FCA 1589.*

³⁸ <https://www.ato.gov.au/Business/Starting-your-own-business/Before-you-get-started/Are-you-in-business/>

³⁹ <https://www.ato.gov.au/non-profit/gifts-and-fundraising/claiming-tax-deductions/is-it-a-gift-or-contribution/>

⁴⁰ Section 30-243 of the Income Tax Assessment Act 1997.

contribution is made in the course of carrying on a business, it might be deductible as ordinary business expenses such as sponsorship and marketing, as discussed below.

4.2.3.3 General expenditure

An expense is deductible against the assessable income under the general deduction provision to the extent that it was incurred in gaining or producing the assessable income or was necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income⁴¹. Expenses of a capital nature are not deductible⁴². What constitutes a business was discussed in section 4.2.3.1 above.

Section 40-880 allows a deduction for expenses incurred prior to commencing trade. The section allows certain business capital expenditure deductible over five years, or immediately in the case of some start-up expenses for small businesses, if:

- (a) the expenditure is not otherwise taken into account; and
- (b) a deduction is not denied by some other provision; and
- (c) the business is, was or is proposed to be carried on for a taxable purpose.

A “taxable purpose” is defined in section 40-25(7)(a) of the ITAA97 as the purpose of producing assessable income. The “purpose of producing assessable income” is in turn defined in section 995-1 of the ITAA97 as: something is done for the purpose of producing assessable income if it is done: for (a) the purpose of gaining or producing assessable income; or (b) in carrying on a business for the purpose of gaining or producing assessable income.

4.2.4 New Zealand

The tax law (Income Tax Act No. 97 of 2007) of New Zealand (New Zealand, 2007) is administered by the Inland Revenue (IR). There are no specific provisions in the Income

⁴¹ Section 8-1(1) of the Income Tax Assessment Act 1997.

⁴² Section 8-1(2) of the Income Tax Assessment Act 1997.

Tax Act 2007 dealing with crowdfunding transactions. The tax consequences of these transactions are therefore determined by using existing tax rules and principles.

4.2.4.1 Donations received

Section CB1 of the Income Tax Act 2007 determines that an amount that is derived from a business is income of a person unless it is of a capital nature (New Zealand 2007).

There has been no gift tax in New Zealand since 2001 and also no general capital gains tax although capital gains tax applies to foreign debt and equity investments (New Zealand Immigration, 2019).

4.2.4.2 Donations made by the donor

Sections LD1 to LD3 grant a natural person a tax credit equal to 33.33% of the lesser of total taxable income or the total qualifying donations made during the year⁴³. A charitable or other public benefit gift is a gift of money of \$5 or more that is paid to a society, institution, association, organisation, trust, or fund that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Schedule 32 also contains a list of qualifying recipients. The donor (natural person) can claim a tax credit if donations are made to an approved organisation and do not provide any direct benefit to the person or his/her family.

4.2.4.3 General expenditure

An expense or loss is deductible in terms of the general permission section⁴⁴ of the Income Tax Act 2007 to the extent to which the expenditure or loss is incurred by them in

⁴³<https://www.ird.govt.nz/income-tax/income-tax-for-individuals/individual-tax-credits/tax-credits-for-donations>

⁴⁴ Part D s DA 1 of the Income Tax Act 2007.

deriving assessable income; or excluded income; or a combination of assessable income and excluded income.

4.3 DEBT MODEL

4.3.1 United States of America

Debt-based crowdfunding could fall within the ambit of “security” as defined by the SEC. Refer to the discussion under section 4.4.2 below.

4.3.2 United Kingdom

The UK has adopted a “twin peaks” model of regulation where the Bank of England is responsible for the monetary policy, financial stability and prudential regulation, whereas the Financial Conduct Authority (FCA) is responsible for market conduct and securities regulation (Ramsay & Kourabas, 2017:55). The Financial Services and Markets Act 2000 (FSMA) (United Kingdom, 2000) provides authority for the FCA to promulgate rules, and the rules for crowdfunding are contained the FCA Handbook (Ramsay & Kourabas, 2017:57). A document titled *The FCA’s regulatory approach to crowdfunding over the Internet, and the promotion of non-readily realisable securities by other media* was published in March 2014 and contains the rules and regulations of debt and equity crowdfunding (Financial Conduct Authority, 2014). This document is also referred to as the FCA’s Policy Statement (PS14/4) (Ramsay & Kourabas, 2017:58). Debt-based and equity-based crowdfunding models are regulated by the FCA whereas only the payment related services of donation-based and rewards-based crowdfunding are regulated by the FCA (Financial Conduct Authority, n.d.).

The Chancellor announced in the Budget 2014 that, in order to increase the choice that ISA savers have about how they invest, the government would make peer-to-peer loans eligible for inclusion within Individual Savings Accounts (ISAs) (HM Treasury, 2014:46). It was also announced that the possibility of including debt securities offered by crowdfunding platforms in the ISA regime, will be explored (HM Treasury, 2014:46).

Following these announcements, various discussion and consultation papers were issued by the Financial Conduct Authority (FCA) (Financial Conduct Authority, 2016a; Financial Conduct Authority, 2016b).

The FCA issued a policy statement (PS16/8) declaring that, from 6 April 2016, the Individual Savings Account Regulations 1998 (ISA Regulations) (United Kingdom, 1998) will allow “peer-to-peer agreements” (also known as ‘article 36H agreements’) to qualify as ISAs, known as the Innovative Finance ISA (IFISA) (Financial Conduct Authority, 2016c:5). It is stated that this policy objective is to “...increase the choice available to ISA investors, encourage the growth of crowdfunding, and may improve competition in the banking sector by diversifying the available sources of finance” (Government of the United Kingdom, 2016).

It was furthermore declared that the Regulated Activities Order will make advising on peer-to-peer (also referred to as P2P) agreements a regulated activity (Financial Conduct Authority, 2016c:5). The activities of crowdfunding platforms making use of the peer-to-peer lending model, have been regulated by the Financial Conduct Authority (FCA) since 6 April 2016. The FCA applies rules designed to ensure that customers understand the risks of these investments and have access to information that allows them to make informed decisions.

4.3.2.1 Tax incentive for the funder: Individual Savings Account (ISA)

There are four types of ISAs, namely a cash ISA, stocks and shares ISA, innovative finance ISA and a lifetime ISA. Innovative finance ISAs include peer-to-peer loans as well as ‘crowdfunding debentures’.

The account rules for an ISA are set out in the Individual Savings Account Regulations 1998 (SI1998/1870) (ISA Regulations) and have been amended with effect from 1 November 2016, to provide that debentures or bonds issued by companies and charities can be held in an innovative finance ISA where they satisfy certain conditions (HM Government, 2016).

Funders making contributions under either the debt-based or the equity-based crowdfunding model will not pay tax on interest earned or on income or capital gains from investments if the investment (project) is classified as an ISA.

4.3.3 Australia

The amount received by the project creator is not taxed since it is capital in nature. However, the project creator will be able to claim the interest expense incurred on the debt as a deduction if they satisfy the provisions of the general deduction in section 8-1 or Division 230 of the ITAA 1997⁴⁵ (see section 4.2.3.3).

The interest received by the funder is assessable income and subject to tax. The funder will be able to claim any business related expense as a tax deduction (see section 4.2.3.3).

4.3.4 New Zealand

The funder can claim interest on money borrowed to buy shares or to invest, as long as that investment will produce taxable income⁴⁶. Dividends and interest received are taxable and are subject to a resident withholding tax.

4.4 EQUITY MODEL

Equity and debt-based crowdfunding emerged as an alternative to bank loans, angel and venture capital for small businesses (World Bank, 2013:15). Some governments amended their regulations in order to allow the issue of securities, if this was not yet allowed.

⁴⁵ <https://www.ato.gov.au/Business/Income-and-deductions-for-business/In-detail/Crowdfunding/>

⁴⁶ <https://www.ird.govt.nz/income-tax/income-tax-for-individuals/types-of-individual-expenses>

4.4.1 United States of America

Equity crowdfunding is governed in the USA by the Jumpstart Our Business Startups Act 2016 (JOBS Act) (USA, 2016) under the authority of the Financial Industry Regulatory Authority (Lieu, 2019).

Before the amendments to the JOBS Act, crowdfunding posed two issues under federal securities law of the USA. The first issue was that the offer and sale of securities in the USA must be registered with the SEC in terms of the Securities Act of 1933 (USA, 1933), unless an exemption from registration was available (Heminway & Hoffman, 2011:880). Since registration is expensive and time consuming, this is not a viable option for early-stage small businesses seeking relatively small amounts of capital (Bradford, 2012:42-43). The cost of complying with regulatory requirements often outweighs the benefits related to the financing method (Heminway & Hoffman, 2011:880). Entrepreneurs therefore rather sell unregistered securities to family and friends who qualify for the private offering exemption⁴⁷ or to accredited investors who qualify for the accredited investor exemption⁴⁸ (Schwartz, 2015a:625). Heminway and Hoffman (2011:884) argue in favour of an exemption from registration for equity crowdfunding by contending that registration is not necessary to protect investors or to maintain market integrity, which are the two principal policies underlying the federal securities laws.

Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012 added section 4(a)(6) to the Securities Act (James, 2013:1768). This section provides an exemption from registration for certain crowdfunding transactions that qualify as the offering of securities (James, 2013:1768). President Obama stated the following in his press release on signing the JOBS Act on 5 April 2012:

And for start-ups and small businesses, this bill is a potential game changer. Right now, you can only turn to a limited group of investors -- including banks and wealthy individuals -- to get funding. Laws that are nearly eight decades old make

⁴⁷ U.S. Code Title 15 §77d(a)(2).

⁴⁸ U.S. Code Title 15 §77d(a)(5).

it impossible for others to invest. But a lot has changed in 80 years, and it's time our laws did as well. Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors -- namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in. (Obama, 2012)

The second issue relates to the crowdfunding platforms. The crowdfunding platform operators could be brokers subject to regulation under the Securities and Exchange Act (USA, 1934) or investment advisers subject to regulation under the Securities and Exchange Act if the investments offered on the platforms are securities as defined (Bradford, 2012:49). These two issues were addressed by the USA government and are discussed below.

4.4.1.1 Regulatory requirements

Securities crowdfunding are divided into three types, namely retail crowdfunding⁴⁹, accredited crowdfunding⁵⁰ and intrastate crowdfunding⁵¹, based on different regulations applicable to each type (Schwartz, 2015b:661). According to Schwartz (2015b:674), retail crowdfunding has the fundamental advantage of “inclusivity” over accredited crowdfunding because it is open to any investor and is not limited to only accredited, wealthy investors.

The term “security” is defined in the Securities Act § 77b(a)(1) and includes a list of financial interests such as stock, bonds, debentures, investment contracts, derivative instruments etc. (USA, 1933) It therefore does not refer only to equity and consequently any type of security can be crowdfunded.

A common law test, known as the *Howey* test, has been developed by the US Supreme Court to determine if a financial instrument is an investment contract (Heminway & Hoffman, 2011:886; Bradford, 2012:30). According to this test the Supreme Court defines

⁴⁹ Title III of the federal JOBS Act of 2012 (Schwartz, 2015b:661).

⁵⁰ Title II of the JOBS Act (Schwartz, 2015b).

⁵¹ Under law of the specific states (Schwartz, 2015b).

an investment contract as “a transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or a third party...”⁵². According to Bradford (2012:31), securities (such as stock, bonds, notes, shares etc.) can’t be offered under the donation model since they are offered with the expectation of profit in return. With donation-based crowdfunding nothing, including profits, is expected in return for the donation made and hence the donation model is also not an investment contract as defined. Similarly project creators of the reward and pre-purchase models do not offer a financial return but a product or service instead, which is seen as a consumption item. Securities are, however, issued under the equity model (Bradford, 2012:33).

Under the *Howey* test, debt-based crowdfunding will be seen as an investment contract if investors are offered interest on their initial capital contribution (Bradford, 2012:35). The *Reves* test is applied if the investor is offered notes, bonds, debentures or other debt interest in order to determine whether it is a security (Heminway & Hoffman, 2011:890; Bradford, 2012:35). According to the *Reves* test, there is a presumption that every note is a security which needs to be dismissed in order to prove that a transaction is not a security⁵³ (Bradford, 2012:36-37). If the note does not fall under the list of securities that are not securities, a “family resemblance” test should be used to affirm or rebut the presumption⁵⁴. Notes that are not securities include:

the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a “character” loan to a bank customer, short-term notes secured by an assignment of accounts receivable, a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized, ...[and] ... notes evidencing loans by commercial banks for current operations.” (Reves v Ernst & Young (1990) 494 US 65)

⁵² *Securities and Exchange Commission v W.J Howey Co. et al.* (1946) 328 US 293.

⁵³ *Reves v Ernst & Young* (1990) 449(94 US 65.

⁵⁴ *Reves v Ernst & Young* (1990) 494 US 65 – 67.

Crowdfunding notes are usually not secured and are without collateral, therefore falling within the ambit of being a “security” and subject to the regulation requirements.

Equity crowdfunding is offering shares (securities) in return for investments. The following regulatory requirements are therefore applicable to equity and debt-based (if classified as “security”) crowdfunding in the USA.

Investment cap

In 2015, the SEC Commission adopted Regulation Crowdfunding to implement the requirements of Title III with effect from 16 May 2016 (SEC, 2016:2). However, not all companies are eligible to use the exemption from registration provided for in the Regulation Crowdfunding. The companies that do not qualify are listed in §227.100 of Regulation Crowdfunding and include: non-U.S.A. companies; companies that already are Exchange Act reporting companies; certain investment companies; companies that are disqualified under Regulation Crowdfunding’s disqualification rules; companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement; and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies (SEC, 2016).

According to §227.100 of Regulation Crowdfunding, the following requirements must be met in order to qualify for the exemption from registering with the SEC:

1. A maximum aggregate amount of \$1,070,000 can be raised in a 12-month period by a company issuing securities in reliance on Regulation Crowdfunding (an “issuer”). In determining the amount that may be sold in a particular offering, an issuer should count:
 - the amount it has already sold (including amounts sold by entities controlled by, or under common control with, the issuer, as well as any amounts sold by any

predecessor of the issuer) in reliance on Regulation Crowdfunding during the 12-month period preceding the expected date of sale, plus

- the amount the issuer intends to raise in reliance on Regulation Crowdfunding in this offering.

An issuer does not aggregate amounts sold in other exempt (non-crowdfunding) offerings during the preceding 12-month period for purposes of determining the amount that may be sold in a particular Regulation Crowdfunding offering.

2. The aggregate amount of securities sold to any investor across all issuers during the 12-month period preceding the date of such transaction, including the securities sold to such investor in such transaction, shall not exceed:
 - if either the investor's annual income or net worth is less than \$107,000: the greater of \$2,200 or 5 percent of the lesser of the investor's annual income or net worth; or
 - if both the investor's annual income and net worth are equal to or more than \$107,000: 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of \$107,000.
3. The crowdfunding transaction should be conducted exclusively through the intermediary's platform that complies with the requirements in section 4A(a) of the Securities Act⁵⁵.
4. The issuer needs to comply with disclosure requirements in section 4A(b) of the Securities Act⁵⁶. The Regulation Crowdfunding furthermore provides specific disclosure requirements in §227.201 that the issuer must file with the Commission and provide to investors and the relevant intermediary in order to qualify for the exemption.

De la Viña and Black (2018:91) compare federal and various states' legislation, identifying the following eight critical departures for crowdfunding legislation: registration, limits on offerings, investment caps on issuers, pre-emption, requirements on notification, and regulations on the use of intermediaries, required filings and post-offering reporting.

⁵⁵15 U.S.C. 77d-1(a).

⁵⁶15 U.S.C. 77d-1(b).

Ganatra (2016:1470-1472) argues that similar protective measures in the form of the registration requirement and the disclosure requirements applicable to the offering of securities, should be implemented for rewards-based crowdfunding. By implementing minimal regulations by crowdfunding platforms and by requiring project creators to disclose certain information, platforms can be made safer and more transparent for the funder and the creator (Ganatra, 2016:1471).

Disclosure requirements

As stated above, there are certain mandatory disclosure requirements in section 4A(b) of the Securities Act that need to be complied with if equity-based crowdfunding is used. The purpose of the disclosure requirements is to provide investors with sufficient information to make informed decisions and to protect investors from fraud (James, 2013:1775). According to James (2013:1780), however, many investors in crowdfunding are financially unsophisticated investors (due to their lack of financial acumen) and therefore the disclosure requirements will aid little in protecting such investors from fraud.

Based on empirical evidence from different types of mandatory disclosures in different fields (such as financial transactions, insurance, health care, etc.), Ben-Shahar and Schneidern (2011:651-652) similarly argue that mandatory disclosure as a regulatory technique generally fails to achieve its goal. Disclosees often do not read the disclosed information and if they do, they do not understand it; and even if they do understand it, they do not use it (Ben-Shahar & Schneidern, 2011:665). According to Ben-Shahar and Schneidern (2011:665), the decisions of the disclosees are seldom improved by mandated disclosures. Disclosures can furthermore lead to unintended consequences that often harm the people they were intended to serve (Ben-Shahar & Schneidern, 2011:737). Unintended consequences result from the fact that disclosures consist of a mixture of mandated and voluntary information which reduces the attention that consumers pay to other information which might affect their decisions (Ben-Shahar & Schneidern, 2011:737-738). Mandated disclosure can furthermore cause inequity since “mandated disclosure helps most those who need help least and helps least those who need help most” (Ben-Shahar & Schneidern, 2011:740). This is because well-educated and wealthy people have

resources and sophistication to interpret and use the information in comparison to the poor, thereby only benefiting the ones who need it least.

Advertising

According to Regulation Crowdfunding §227.204, an issuer is only allowed to issue a notice that advertises the terms of an issuer's offering if it directs the investors to the intermediary's platform. The terms and limited factual information about the offering is the only information that may be made available. The issuer is not allowed to advertise the terms of an offering directly or indirectly in any other manner.

4.4.1.2 Tax incentives

There are no specific tax incentives for equity crowdfunding in the USA. However, tax incentives are available if an investor invests in a qualified small business engaged in certain qualified trades (Turlington, n.d.).

Section 1202 of the IRC provides that gains (up to \$10 000 000 cumulative) on the disposal of shares held in a qualified small business are not taxed if they have been held for more than five years. Section 1244 of the IRC provides for a loss of up to a maximum of \$50 000 on the disposal of shares in a qualified small business, to be treated as an ordinary loss rather than a capital loss. If shares in a qualified business are sold within six months and such gains are used to buy shares in another qualified small business, section 1045 provides for such gain to be recognised only to the extent that the amount realised on such sale exceeds the cost of any qualified small business stock purchased by the taxpayer. The taxpayer should acquire the new shares within 60 days from the date of such sale (Turlington, n.d.).

4.4.2 United Kingdom

As discussed under section 4.3.2, equity crowdfunding is regulated by the FCA which is responsible for market conduct and securities regulation (Ramsay & Kourabas, 2017:55).

The Financial Services and Markets Act 2000 (FSMA) (United Kingdom, 2000) provides authority for the FCA to promulgate rules. The rules for equity crowdfunding are contained in the FCA Handbook. A document titled *The FCA's regulatory approach to crowdfunding over the Internet, and the promotion of non-readily realisable securities by other media* was published in March 2014, and contains the rules and regulations of debt and equity crowdfunding (Financial Conduct Authority, 2014). This document is also referred to as the FCA's Policy Statement (PS14/4) (Ramsay & Kourabas, 2017:58). The FCA's Policy Statement contains Appendix 1 which is the *Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014* (Financial Conduct Authority, 2014:7). This instrument amended the FCA Handbook to regulate debt and equity crowdfunding.

4.4.2.1 Regulatory requirements

In terms of Part II, section 19 of the FSMA, a person may only carry on a regulated activity in the United Kingdom if he is an authorised person or an exempt person. What constitutes a regulated activity is set out in section 21 of the FSMA and includes activity of a specified kind which is carried on by way of business and relates to an investment of a specified kind or, in the case of an activity of a kind which is also specified for the purposes of this paragraph, is carried on in relation to property of any kind.⁵⁷ "Investment" includes any asset, right or interest⁵⁸.

Section 755 of the Companies Act 2006 (United Kingdom, 2006) prohibits a private company limited by shares or limited by guarantee and having a share capital, from offering any securities of the company to the public, or of allotting or agreeing to allot any securities of the company with a view to their being offered to the public. It is therefore only a public company that makes use of equity crowdfunding. Section 763 of the Companies Act 2006 (United Kingdom, 2006) determines that a public company's minimum nominal value of allotted share capital is £50 000.

⁵⁷ Section 21(1)(a)-(b) of the Financial Service and Management Act 2000.

⁵⁸ Section 21(4) of the Financial Service and Management Act 2000.

One of the modules in the FCA Handbook is the Conduct of Business sourcebook (COBS). COBS 4.7.7 R determines that a firm must not communicate or approve a direct-offer financial promotion relating to a non-readily realisable security, a peer-to-peer agreement, or a peer-to-peer portfolio to or for communication to a retail client without certain listed conditions being satisfied. The first condition is that the retail client recipient of the direct-offer financial promotion is one of the following:

- (a) certified as a 'high net worth investor' in accordance with COBS 4.7.9 R;
- (b) certified as a 'sophisticated investor' in accordance with COBS 4.7.9 R;
- (c) self-certified as a 'sophisticated investor' in accordance with COBS 4.7.9 R; or
- (d) certified as a 'restricted investor' in accordance with COBS 4.7.10 R.

The second condition is that the firm itself or the person who will arrange or deal in relation to the non-readily realisable security, or the person who will facilitate the retail client becoming a lender under a peer-to-peer agreement or a peer-to-peer portfolio, will comply with the rules on appropriateness (see COBS 10 and 10A) or equivalent requirements for any application or order that the firm or person is aware, or ought reasonably to be aware, is in response to the direct offer financial promotion⁵⁹.

COBS 4.7.8 R determines that a firm may communicate or approve a direct-offer financial promotion relating to a non-readily realisable security, a peer-to-peer agreement or a peer-to-peer portfolio to or for communication to a retail client if:

- (1) the firm itself will comply with the suitability rules (COBS 9 and 9A) in relation to the investment promoted; or
- (2) the retail client has confirmed before the promotion is made that they are a retail client of another firm that will comply with the suitability rules (COBS 9 and 9A) in relation to the investment promoted; or
- (3) the retail client is a corporate finance contact or a venture capital contact.

⁵⁹ COBS 4.7.7 R <https://www.handbook.fca.org.uk/handbook/COBS/4/7.htm#DES612> (Accessed 21 April 2020).

To be a high net worth investor, a declaration should be signed by the investor that the investor accepts that the investments to which the promotions will relate may expose him/she to a significant risk of losing all of the money or other property invested and that at least one of the following applies to the investor: the investor had, throughout the financial year immediately preceding the date of declaration, an annual income to the value of £100,000 or more or net assets to the value of £250,000 or more⁶⁰.

A certified sophisticated investor is an individual who has a written certificate signed within the last 36 months by a firm confirming he/she has been assessed by that firm as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in non-mainstream pooled investments; and who has signed, within the period of twelve months ending with the day on which the communication is made, a statement acknowledging the risk of losing all of the investment and the right to seek advice from an authorised person⁶¹.

A self-certified sophisticated investor is an investor who declares that at least one of the following applies in addition to a statement acknowledging the risk of losing all of the investment and the right to seek advice from an authorised person:

- (a) A member of a network or syndicate of business angels and have been so for at least the last six months prior to the date of declaration;
- (b) Have made more than one investment in an unlisted company in the two years prior to the date of declaration;
- (c) Are working, or have worked in the two years prior to the date of declaration, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

⁶⁰ COBS 4.12.6 R <https://www.handbook.fca.org.uk/handbook/COBS/4/7.html#DES612> (Accessed 21 April 2020).

⁶¹ COBS 4.12.7 R <https://www.handbook.fca.org.uk/handbook/COBS/4/7.html#DES612> (Accessed 21 April 2020).

(d) Are currently, or have been in the two years prior to the date of declaration, a director of a company with an annual turnover of at least £1 million⁶².

A restricted investor is a retail investor who has signed a declaration that, in the twelve months preceding the date of the statement, they have not invested more than 10% of their net assets in non-readily realisable securities; and they undertake that in the twelve months following the date of the statement, they will not invest more than 10% of their net assets in non-readily realisable securities (unlisted shares, unlisted debt securities)⁶³.

Sophisticated investors are therefore allowed to invest as much as they want through equity crowdfunding while a limit is placed on the amount that non-sophisticated investors (restricted retail investors) are allowed to invest.

4.4.2.2 *Tax incentives*

In addition to incentives for venture capital trusts (which are comparable to SA's VCC where you invest via another company and not directly), the UK has venture capital schemes that offer tax incentives to individuals. The venture capital schemes are the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS), and the Social Investment Tax Relief (SITR). The purpose of the venture capital schemes tax incentives is to encourage individuals to invest in companies and social enterprises that are not listed on any recognised stock exchange⁶⁴. The relief is provided in two forms, namely income tax relief and capital gains tax relief. There is no income tax relief for the dividend income received from the investment.

⁶² COBS 4.12.8 R <https://www.handbook.fca.org.uk/handbook/COBS/4/7.html#DES612> (Accessed 21 April 2020).

⁶³ COBS 4.7.10 R <https://www.handbook.fca.org.uk/handbook/COBS/4/7.html#DES612> (Accessed 21 April 2020).

⁶⁴ <https://www.gov.uk/guidance/venture-capital-schemes-tax-relief-for-investors>

The income tax relief is not available if the person and his/her associates are connected with the company. They are connected when the person or associates are employed by the company, or are a subsidiary, or hold a total of more than 30% of the company's shares, voting rights or rights to assets if the company is wound-up.

Enterprise Investment Scheme

Part 5 of the Income Tax Act 2007 (United Kingdom, 2007) deals with EIS, and Part 5A deals with SEIS. The main provisions of Part 5 and Part 5A of the Income Tax Act are summarised below. It is also indicated in the comparison where provisions are the same or similar.

Table 7: Comparison of EIS and SEIS relief provisions (Own construct)

PART 5 ELIGIBILITY OF THE INDIVIDUAL FOR EIS RELIEF (S 157)	PART 5A ELIGIBILITY OF THE INDIVIDUAL FOR SEIS RELIEF (S 257AA)	COMPARISON
(a) Shares are issued to the investor		
(aa) Shares are issued before 6 April 2025		
(b) Investor is a qualifying investor (Chapter 2)		
No connection with the issuing company (s 163, s 166-171)		
<ul style="list-style-type: none"> Employees, directors and partners (ss 167-169) 	No employee investors (s 257BA)	
<ul style="list-style-type: none"> Persons interested in capital etc. of company (s 170) 	No substantial interest in the issuing company (s 257BB, s257BF)	Same (EIS refers to "connected" vs SEIS "substantial interest")
<ul style="list-style-type: none"> Persons subscribing for shares under certain arrangements (s 171) 	No related investment arrangements (s 257BC)	Similar
No linked loans (s 164)	No linked loans (s 257BD)	Same
Existing shareholdings (s 164A)		
No tax avoidance (s 165)	No tax avoidance (s 257BE)	Same
(c) General requirements are met (Chapter 3)		
The shares (s 173)	The shares (s 257CA)	Same
Maximum amount raised annually		

PART 5 ELIGIBILITY OF THE INDIVIDUAL FOR EIS RELIEF (S 157)	PART 5A ELIGIBILITY OF THE INDIVIDUAL FOR SEIS RELIEF (S 257AA)	COMPARISON
(s 173A)		
Maximum risk finance investments at the issue date (s 173AA)		
Maximum risk finance investments at times during period B (s 173AB)		
Purpose of the issue (s 174)	Purpose of the issue (s 257CB)	Similar
Use of the money raised (s 175)	Spending of the money raised (s 257CC)	
Permitted maximum age (s 175A)		
Minimum period (s 176)		
No pre-arranged exits (s 177)	No pre-arranged exits (s 257CD)	Same
No tax avoidance (s 178)	No tax avoidance (s 257CE)	Same
No disqualifying arrangements (s 178A)	No disqualifying arrangements (s 257CF)	Same
(d) Issuing company is a qualifying company (Chapter 4)		
UK permanent establishment (s 180A)	UK permanent establishment (s 257DD)	Same
Financial health (s 180B)	Financial health (s 257DE)	Same
Trading (s 181-182)	Trading (s 257DA-257DB)	Same
Carrying on of a qualifying business activity (s 183)	Carrying on of a qualifying business activity (s 257DC)	Same
Unquoted status (s 184)	Unquoted status (s 257DF)	Same
Control and independence (s 185)	Control and independence (s 257DG)	Some similarities
	No partnerships (s 257DH)	
Gross assets (s 186)	Gross assets (s 257DI)	
Number of employees (s 186A)	Number of employees (s 257DJ)	
	No previous other risk capital scheme investments (s 257DK)	
	The amount raised through the SEIS (s257DL)	
Qualifying subsidiaries (s 187)	Qualifying subsidiaries (s 257DM)	Same
Property managing subsidiaries (s 188)	Property managing subsidiaries (s 257DN)	Same

PART 5 ELIGIBILITY OF THE INDIVIDUAL FOR EIS RELIEF (S 157)	PART 5A ELIGIBILITY OF THE INDIVIDUAL FOR SEIS RELIEF (S 257AA)	COMPARISON
Other reliefs		
Gains or losses on disposal of shares (s 150A of TCGA 1992)	Gains or losses on disposal of shares (s 150E of TCGA 1992)	
Re-investment of proceeds (Schedule 5B to TCGA 1992)	Re-investment of proceeds (Schedule 5BB to TCGA 1992)	

From the table above, it is evident that some of the provisions of the EIS and SEIS reliefs are similar. This assist in simplifying the application of the legislation. For the individual investors to qualify for the relief, the company in which they invest must comply with the rules of the EIS. The company must have a permanent establishment in the UK and must not trade on a recognised stock exchange at the time of the share issue and must also not plan to do so. Furthermore the company must not control another company other than qualifying subsidiaries. The company must also not be controlled by another company, must not have more than 50% of its shares owned by another company and must not expect to close after completing a project or series of projects.

The money raised by the new share issue must be used for a qualifying business activity, which is either a qualifying trade, preparing to carry out a qualifying trade (which must start within two years of the investment) or research and development that is expected to lead to a qualifying trade. The money raised by the new share issue must be spent within two years of the investment, or if later, the date that the company started trading. The money cannot be used to buy all or part of another business, cannot pose a risk of loss to capital for the investor and should be used to grow or develop the business of the company⁶⁵.

The company in which the investor invests, is allowed to receive a maximum of £5 million in any 12-month period and a maximum of £12 million during the lifetime of the company. In calculating these limits, investment in other venture capital schemes should also be taken into account. The company must receive investment under a venture capital

⁶⁵ <https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme>

scheme within seven years of its first commercial sale. The gross assets of the company cannot be more than £15 million and the company should employ fewer than 250 full-time equivalent employees⁶⁶.

For an investor to qualify for the EIS relief, the investor should hold the shares for at least three years and must be a UK resident. The investor can invest a maximum of £1 000 000 per annum (this is increased to £2 million if at least £1 million of that is invested in knowledge-intensive companies).

The EIS income tax relief stipulations are as follows:

- The investor can claim an income tax relief equal to 30% of the investment amount.
- If the person qualifies for the income tax relief, there is no capital gains tax if the shares in the EIS are sold after three years.
- If the proceeds from the disposal of any asset are used to buy EIS shares, the full capital gain on the disposal of that asset is deferred. The investment must be made between one calendar year before and three calendar years after the asset was sold. The capital gains tax will only be payable in the year when the investment is sold, cancelled, redeemed, repaid or when the company stops meeting the requirements for EIS or when the person becomes a non-resident. This relief is only available if the person qualified for the income tax relief. However, if the income tax relief is not available, the person will still get the capital gains tax deferral relief if the person is connected with the company.
- If the EIS shares are sold at a loss, the difference between the loss amount and the income tax relief can be claimed as a deduction against income.

A quantitative and qualitative research study was undertaken on instruction of the HMRC into the use and impact of the EIS as well as VCTs (Colahan *et al.*, 2016:2). The following are some of the findings from this study:

- 79% of the respondents of random-probability telephone surveys conducted, indicated that the income tax relief was either essential (32%) or very important

⁶⁶ <https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme>

(47%) in their investment decisions (Colahan *et al.*, 2016:7). Through qualitative in-depth interviews with some investors, it was determined that some investors who mainly invested for entrepreneurial or philanthropic reasons, would have invested regardless of the tax reliefs (Colahan *et al.*, 2016:8). They did, however, also indicate that they were able to invest higher amounts due to the tax reliefs (Colahan *et al.*, 2016:8).

- In qualitative in-depth interviews with seven investees and eight investors, several indicated that they do not consider VCTs as high-risk investments (Colahan *et al.*, 2016:8).
- There is room for both EIS and VCT investors and they are not “crowding each other out” (Colahan *et al.*, 2016:8).

Cicchiello, Battaglia and Monferrà (2019) compared tax incentives in Europe (UK, France, Italy, Spain and Belgium). They determined that the up-front tax credits on the amounts invested are the most used forms of tax incentives (Cicchiello *et al.*, 2019:1873). They furthermore suggest that the tax incentives used in the UK (SEIS and EIS) are more likely to work in crowdfunding (Cicchiello *et al.*, 2019:1877). There was, however, no conclusive evidence on the effectiveness of the tax incentives due to a lack of data (Cicchiello *et al.*, 2019:1878).

Seed Enterprise Investment Scheme

During April 2012, the UK introduced tax incentives at a higher rate than the EIS for equity investing, referred to as the Seed Enterprise Investment Scheme (SEIS). For an investor to qualify for the SEIS relief, the investor can invest a maximum of £100 000 per annum, should hold the shares for at least three years and must be a UK resident.

The company in which the investor invests, is allowed to receive a maximum of £150 000 during the life of the company through SEIS, the gross assets of the company cannot be more than £200 000 and the company should employ fewer than 25 full-time equivalent employees.

The SEIS income tax relief stipulations are as follows:

- The investor can claim a tax relief equal to 50% of the investment amount.
- If the person qualifies for the income tax relief, there is no capital gains tax if the shares in the SEIS are sold after three years.
- If the proceeds from the disposal of any asset are used to buy SEIS shares, the capital gain on the disposal of that asset is deferred.
- If the proceeds from the disposal of any asset are used to buy SEIS shares, 50% of the capital gain on the disposal of that asset is exempt from capital gains tax. The maximum amount that a person can be exempt from, however, is £50 000. The investment must be made in the same tax year that you claim income tax relief on the investment. The capital gains tax will only be payable in the year when the investment is sold, cancelled, redeemed, repaid or when the company stops meeting the requirements for EIS or when the person becomes a non-resident. This relief is only available if the person qualifies for the income tax relief.
- If the shares are sold at a loss, the investor can claim 50% of the loss of the SEIS investment as an income tax relief by multiplying it by the marginal tax rate at which the investor is taxed.

In a study conducted by Chen, Lin and Zhang (2018:23-24) it was determined that, after implementation of the SEIS, more investors invested in projects eligible for the SEIS than before the implementation of the SEIS. Investors also invested more money in each such SEIS project. The tax incentive also altered the ability of part of the crowd to distinguish between start-ups that are of high quality and those that are doomed to failure. This is because the so-called sophisticated investors (investors with more experience and higher ability to screen early stage start-up opportunities) invested more money in SEIS projects. Their attention shift therefore impacted upon the survival and growth of funded projects that are not eligible for the SEIS (Chen *et al.*, 2018:23).

Social Investment Tax Relief

For an investor to qualify for the SITR relief, the investor can invest a maximum of £1 000 000 per annum. The SITR income tax relief stipulations are as follows:

- The investor can claim a tax relief equal to 30% of the investment amount.
- If the proceeds from the disposal of any asset are used to buy SISR shares, the full capital gain on the disposal of that asset is deferred if the person has received the income tax relief. The investment must be made between one calendar year before and three calendar years after the asset is sold. The capital gains tax will only be payable in the year when the investment is sold, cancelled, redeemed, repaid or when the company stops meeting the requirements for SISR or when the person becomes a non-resident. This relief is only available if the person qualifies for the income tax relief.

4.4.3 Australia

The Australian Government committed to relaxing regulatory requirements to make it easier for small business to obtain finance through equity crowdfunding (Australian Government, 2015). Consequently, the Corporations Act 2001 was amended on 29 September 2017 through the Corporations Amendment Act (Crowd-sourced Funding) Act 2017 to allow certain public unlisted companies to raise funding by means of the crowdfunding equity model. On 21 September 2018 the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Act 2018 again amended the Corporations Act 2001 to also allow private companies to issue shares through equity crowdfunding (Australian Government, 2018).

4.4.3.1 Regulatory requirements

Section 738C of the Corporations Act 2001 determines that a crowd-sourced funding intermediary is a financial services licensee whose license expressly authorises the licensee to provide a crowdfunding service. This means that the equity crowdfunding platform must first obtain an Australian Financial Service License from the Australian Securities and Investment Commission (ASIC) (Kourabas & Ramsay, 2018:578). The

platform has certain gatekeeper obligations which requires it to conduct checks before publishing a CSF offer document⁶⁷.

In order to qualify for crowdfunding, the project owner must be a public company limited by shares, or a proprietary company that has at least two directors and meets all the other requirements (if any) prescribed by the regulations⁶⁸. The company's assets and annual revenue should not exceed \$25 million⁶⁹. The company is only allowed to raise a maximum of \$5 million a year through the use of equity crowdfunding⁷⁰ (Australian Government, 2017). Retail client investors are allowed to invest a maximum of \$10 000 in any 12 month period⁷¹ (Kourabas & Ramsay, 2018:582-583). A retail client is defined in section 761G(7) of the Corporations Act 2001.

4.4.3.2 Tax incentives

Division 360 of the Income Tax Assessment Act 1997 provides tax incentives for investors who invest in early stage innovation companies (ESIC). A company needs to comply with the requirements referred to as the "early stage test" as well as either the "100-point innovation test" or the "principle-based innovation test"⁷². An investor investing in an ESIC is entitled to the following tax incentives (Australian Tax Office, 2019):

- The investor can claim an amount equal to 20% of the amount paid for the qualifying investment as a tax credit⁷³. The tax credit is, however, limited to \$200 000 in total for the investor and affiliates of the investor per annum. Any unused amount can be carried forward to the next tax year⁷⁴.

⁶⁷ Section 738Q of the Corporations Act 2001.

⁶⁸ Section 738H(1) of the Corporations Act 2001.

⁶⁹ Section 738H(2) of the Corporations Act 2001.

⁷⁰ Section 738G(1) of the Corporations Act 2001.

⁷¹ Section 738ZC(1) of the Corporations Act 2001.

⁷² Section 360-40 and 360-45 of Income Tax Assessment Act, 1997 sets out the requirements for a company to be classified as an early stage innovation company.

⁷³ Section 4-10 of Income Tax Assessment Act, 1997 refers to a "tax offset" which reduces the amount of income tax that you have to pay.

⁷⁴ Section 360-25 of Income Tax Assessment Act, 1997.

- Modified capital gains treatment⁷⁵ applies as follows:
 - The capital gain is disregarded if the qualifying shares are held for a continuous period of at least 12 months but less than 10 years.
 - If the shares are held for less than 10 years, any capital loss on the disposal of the shares should be disregarded.
 - If the shares are sold after 10 years, the base cost of the shares becomes its market value determined on the tenth anniversary of the issue of the shares. Effectively, capital gains tax is only applicable on the capital gain arising after 10 years.

If the investor is not a “sophisticated investor”⁷⁶ or a “professional investor”⁷⁷, the total investment that the investor can make in qualifying ESICs is limited to \$50 000 per annum in order to qualify for the above tax incentives⁷⁸. The tax incentive is furthermore available to resident and non-resident investors of Australia.

4.4.4 New Zealand

Equity crowdfunding in New Zealand is regulated primarily by the Financial Market Authority (FMA) (Kavanagh, 2017). The Financial Markets Conduct Act 2013 (FMC Act) and the Financial Markets Conduct Regulations 2014 (FMC Regs) govern financial products (Kourabas & Ramsay, 2018:576). The definition of financial products in the FMC Act includes debt and equity securities⁷⁹, thereby also applying to debt and equity crowdfunding.

⁷⁵ Section 360-50 of Income Tax Assessment Act, 1997.

⁷⁶ A “sophisticated investor” is an investor who meets the requirements set out in the Corporations Act, 2001 subsections 708(8).

⁷⁷ Referred to in the Corporations Act, 2001 subsections 708(11).

⁷⁸ Section 360-20 of Income Tax Assessment Act, 1997.

⁷⁹ Section 7 of Part 1 of the Financial Markets Conduct Act 2013.

4.4.4.1 Regulatory requirements

The FMC Act requires that, if a financial product is offered to an investor, certain information needs to be disclosed⁸⁰ to the investor unless an exemption applies (Financial Markets Authority, 2013:12). In terms of Schedule 1 of the FMC Act, disclosure is not required for wholesale investors⁸¹ or for small offers of debt and equity⁸². A person is a wholesale investor if, among other things, the person meets certain listed investment activity criteria⁸³, the person is large⁸⁴, is an eligible investor⁸⁵ or the minimum amount payable by the person is at least \$750 000.

Part 6 of the FMC Act⁸⁶ specifically allows for crowdfunding platforms to be licensed, with the aim of facilitating regulated peer-to-peer and equity crowdfunding services to operate in New Zealand (Financial Markets Authority, 2013:20). Section 396 of the FMC Act allows the FMA to issue a license if the FMA is satisfied that a number of requirements have been met. One of the requirements is that the applicant is, or will be, registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (New Zealand, 2008) on and from commencing the provision of that service. If the financial product is offered through such a licensed crowdfunding platform, disclosure is not required⁸⁷.

Investment cap

The FMC Act does not contain restrictions on the type or size of the company that may use equity crowdfunding (Kourabas & Ramsay, 2018:582). One of the eligibility criteria for

⁸⁰ Mandatory disclosure requirements applying to standard offers of financial products are contained in Part 3 of the Financial Markets Conduct Act 2013.

⁸¹ Clause 3 of Schedule 1 of the Financial Markets Conduct Act 2013.

⁸² Clause 12 of Schedule 1 of the Financial Markets Conduct Act 2013.

⁸³ Clause 38 of Schedule 1 of the Financial Markets Conduct Act 2013.

⁸⁴ Clause 39 of Schedule 1 of the Financial Markets Conduct Act 2013.

⁸⁵ Clause 41 of Schedule 1 of the Financial Markets Conduct Act 2013.

⁸⁶ Section 390 of Part 6 of the Financial Markets Conduct Act 2013.

⁸⁷ Clause 6 of Schedule 1 of the Financial Markets Conduct Act 2013.

licences for a crowdfunding service is that the platform should have adequate systems and procedures in place to ensure that each issuer does not raise more than \$2 million in any 12-month period under the service⁸⁸. The same limitation applies to peer-to-peer lending⁸⁹. The \$2 million cap is therefore applied by using any combination of equity crowdfunding, peer-to-peer lending and small personal offers (Kavanagh, 2017).

In a study conducted by Schwartz (2018), it is argued that the two main policy goals of crowdfunding are that it should be an inclusive system and that it should also be efficient. According to an empirical analysis done by Schwartz (2018:954), crowdfunding in New Zealand is financially more successful than in the USA. This is mainly because the system in New Zealand focuses solely on efficiency whereas the USA focuses on both (Schwartz, 2018:954).

Efficiency in the crowdfunding regulation in New Zealand is obtained by the following:

- Platforms acting as gatekeepers, whereby the platform's management needs to be impressed before the platform will allow the project (Schwartz, 2018:931-933). This gatekeeper role of the platform is followed more strictly and seriously in New Zealand than in the USA (Schwartz, 2018:932).
- No cap on the amount of investment that an individual investor can make (Schwartz, 2018:934). This allows lead investors to invest and thereby lead the crowd by signalling that the company is sound (Schwartz, 2018:935). This does not necessarily happen in the USA since the limitations imposed on the amount that an individual invests, do not make it economically feasible for an investor to take the role as a lead investor (Schwartz, 2018:936).
- Allowing direct advertising without limitation (Schwartz, 2018:938). Since the regulation in New Zealand does not prohibit direct advertising, it allows project creators to contact their pre-existing crowd of supporters.

⁸⁸ Regulation 186(g) of the Financial Markets Conduct Regulations 2014.

⁸⁹ Regulation 187(g) of the Financial Markets Conduct Regulations 2014.

- Since New Zealand is smaller than the USA, the reputation of entrepreneurs plays a bigger role than it does in the USA (Schwartz, 2018:941). Crowdfunding entrepreneurs in New Zealand can be expected to behave themselves because the effect of bad publicity on the Internet via Facebook etc. will be bigger (Schwartz, 2018:941).

Although the above aids in the crowdfunding regulation being more efficient, it does compromise on inclusivity. Schwartz (2018:951,953) argues that whether or not efficiency or inclusivity needs to be priority depends on whether or not a country’s venture capital and angel market are effective. If the venture capital and angel capital markets are effective, a country can afford to design a relatively inefficient crowdfunding market, favouring inclusivity (such as in the USA).

Dellorso (2017) submits that equity crowdfunding is more successful in the UK than in the USA because the equity crowdfunding in the UK contains fewer restrictions with no caps on the investment amount for the issuer and the investor, less burdensome and costly reporting requirements, and more favourable available tax incentives in the form of the EIS and SEIS. The following table compares some of the above factors in the USA, the UK, Australia and New Zealand, in order to determine whether their systems support inclusivity and/or efficiency.

Table 8: Equity crowdfunding regulation comparison (Own construct)

FACTOR	USA	UK	AUSTRALIA	NEW ZEALAND
Gatekeeper role of platform	Platform needs to act as gatekeeper but rules are not that stringent	Yes	Yes	Yes
Cap on investment amount of investor	Yes	Yes, only for non-sophisticated investors (not more than 10% of net investable assets)	Yes	No
Cap on investment amount of issuer	Yes, \$1 070 000	No	Yes, \$5 million	Yes, \$2 million
Impact of reputation based on size of country	Small impact	Big impact	Big impact	Big impact

Since the UK, Australia and New Zealand are smaller than the USA, the reputation of entrepreneurs plays a bigger role in these countries than in the USA. Between these three countries which are comparable in size, the main difference is that the UK does not place a cap on the investment amount of the issuer, while New Zealand, in contrast, does not place a cap on the investment amount of the investor. Australia places caps on both the investor and the issuer.

4.4.4.2 Tax incentives

New Zealand does not have specific tax incentives for crowdfunding in their Income Tax Act 2007.

4.5 CONCLUSION

There is a trade-off between efficiency and inclusivity in the regulation of crowdfunding. Regulation is necessary to protect investors as well as to avoid erosion of the tax base by enforcing certain disclosure requirements and responsibilities on the platform. However, too stringent regulation in the form of investment caps and costly reporting requirements might impact inclusivity negatively.

Striking a balance between efficiency and inclusivity in regulating crowdfunding will depend on the policy goals of the government. Most countries focus their regulation of equity crowdfunding by imposing regulations on the platforms, mainly by requiring the platforms to be licensed and by imposing ongoing obligations on the platform. Common regulatory mechanisms employed by governments focus on regulating equity and debt-based crowdfunding platforms. These mechanisms include licencing requirements of the crowdfunding platform, regulating the investment opportunities of the funders (by placing investment caps on the amounts that can be invested for certain funders) and *ex post* governance regulation of the project creators (requiring them to make certain disclosures etc.).

Existing tax laws and principles are applied to determine the tax consequences of the donation and reward crowdfunding models in the USA, UK, Australia and New Zealand. For the donation model, the main issues are to determine whether or not a true donation has been made in order for the amount not to be taxable by the project creator. Various instances of case law have been considered to determine whether a donation has been made or not.

For the rewards model it will have to be determined whether a business is being carried on or whether the project is only a hobby. If the project creator is carrying on a business, the contribution is included in gross income and the project creator will be entitled to claim certain expenditure as a deduction. Pre-trade expenditure can only be claimed once trading commences, which could result in aggravating the existing cash-flow problem of start-ups.

Specific tax incentives have been implemented for the debt and equity models in the UK and Australia. Different types of incentives were identified and include up-front tax incentives for investors on the amount invested, exemption of interest and dividends, and incentives on the disposal of assets. Table 9 summarises the different tax incentives available in the different countries for investments in shares. Table 10 that follows summarises the equity crowdfunding regulations.

Table 9: Tax incentives comparison (Own construct)

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
Maximum amount that company can raise in lifetime of company	£150,000	£1.5 million	£12 million or £20 million for knowledge-intensive company. (A maximum of £5 million in any 12-month period).	£12 million or £20 million for knowledge-intensive company.	N/a
	To calculate the limit of of £150,000 amounts received from any other de minimise state aid in the three years up to and including the date of the investment must be taken into account. The amount received from SEIS will in turn be taken into account in calculating the limits for amounts received through other venture capital schemes in future.	To calculate the limit of £1.5 million, amounts received by subsidiaries, former subsidiaries or businesses acquired must be taken into account.	To calculate the limit of £5 million, amounts received from EIS, VCT, SEIS, SITR as well as state aid approved under the risk finance guidelines have to be taken into account.		

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
Company requirements	<p>The company (or group of companies if it is the parent company) should be less than two years old.</p> <p>The value of the company's assets should not be more than £200,000.</p> <p>The company should have less than 25 employees and should not have previously carried on a different trade.</p>	<p>The social enterprise must be either a community interest company, community benefit society, a charity, an accredited social impact contractor or another body prescribed by Treasury.</p> <p>The value of the company's assets should not be more than £15 million before the investment is made and £16 million after the investment has been made.</p> <p>The company should have less than 250 employees.</p>	<p>The company (or group of companies if it is the parent company) may qualify if at the time of investment, it has not been more than 7 (10 years for a knowledge-intensive company) years since the company's first commercial sale.</p> <p>The value of the company's assets should not be more than £15 million before the investment is made and £16 million after the investment has been made.</p> <p>The company should have less than 250 (500 if it is a knowledge-intensive company) employees.</p>	<p>A VCT is a company that has been approved by HMRC and invests in, or lends money to, unlisted companies.</p> <p>The investment should not be made more than 7 years after its first commercial sale.</p> <p>The value of the company's assets should not be more than £15 million before the investment is made and £16 million after the investment has been made.</p> <p>The company should have less than 250 (500 if it is a knowledge-intensive company) employees.</p>	<p>A company will be a qualifying ESIC at the time of investment if it:</p> <ul style="list-style-type: none"> • is not listed on any stock exchange; • has been incorporated in Australia: <ul style="list-style-type: none"> ○ in the last three years; or ○ prior to the last three years but has received an Australian Business Number in the last three years; or ○ *in the last six years and total expenditure in the previous three income years does not exceed \$1 million;

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
	The company will not qualify if EIS or VCT investments were previously made in the company.				<ul style="list-style-type: none"> • *had expenditure of \$1,000,000 or less in the prior income year; • *had assessable income of \$200,000 or less in the prior income year; and • is involved in innovation, by either <ul style="list-style-type: none"> ○ satisfying the principles-based test or ○ satisfying the 100-point innovation test. <p>*Of the company and it's 100% subsidiaries (if any).</p>
Investor requirements		The investors must either buy new shares or lend money to the investee as a new debt investment.			<p>An investor will qualify for the incentives if it:</p> <ul style="list-style-type: none"> • is not a widely-held company or a 100% subsidiary of a widely-held

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
		<p>If new shares are bought, the shares issued to investors must be paid fully paid for in cash at the time the investment is made and must not be preference shares.</p> <p>If a new debt investment/loan is being made available, it must be made available in cash, in a single or several payments, must not be secured on any assets, not be required to be settled until at least three years after the investment and interest must not be charged at a rate higher than a reasonable commercial interest rate.</p>			<p>company; and</p> <ul style="list-style-type: none"> • is either: <ul style="list-style-type: none"> ○ a sophisticated investor pursuant to subsection 708(8), 708(10) or 708(11) of the Corporations Act 2001; or ○ a non-sophisticated investor that has invested \$50,000 or less in the income year; • does not hold more than 30% of the equity shares in that company or in an entity connected with the company immediately after the acquisition; • the issue of the shares is not an acquisition under

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
					an employee share scheme.
Tax incentive: Income Tax relief	Investor can claim 50% of investment (non-refundable).	Investor can claim 30% of investment (non-refundable).	Investor can claim 30% of investment (non-refundable).	Investor can claim 30% of investment (non-refundable).	Investor can claim 20% of investment (non-refundable).
	The investment amount on which the 50% is calculated is limited to a maximum annual investment of £100,000.	The investment amount on which the 30% is calculated is limited to a maximum annual investment of £1 million.	The investment amount on which the 30% is calculated is limited to a maximum annual investment of £1 million. This is increased to £2 million if at least £1 million of the amount is invested in knowledge-intensive companies.	A maximum VCT relief of £200,000 can be claimed by a natural person in a tax year.	The relief is capped at \$200,000 per investor (including affiliates) per year.
	Unused Income Tax relief cannot be carried forward to future tax years.	Unused Income Tax relief cannot be carried forward to future tax years.	Unused Income Tax relief cannot be carried forward to future tax years.		Can carry forward unused tax relief to future tax years (limited to \$200,000 per investor (including affiliates). This limit includes the amount of the tax relief claimed in the year.

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
	No tax relief on income from dividends.	No tax relief on income from dividends.	No tax relief on income from dividends.	Tax relief on income from dividends (for newly-issued and shares previously owned).	
	<p>Relief can be claimed in the tax year that the investment was made or in the prior tax year if the investor elected for it.</p> <p>The relief can only be claimed against Income Tax payable in the UK.</p>	<p>Relief can be claimed in the tax year that the investment was made or in the prior tax year if the investor elected for it.</p> <p>The relief can only be claimed against Income Tax payable in the UK.</p> <p>No previous investment (shares or debt) should have been made by the investor to that company. An exception is where the previous shares were issued when the company was</p>	<p>Relief can be claimed in the tax year that the investment was made or in the prior tax year if the investor elected for it.</p> <p>The relief can only be claimed against Income Tax payable in the UK.</p>	<p>Relief should be claimed in the tax year that the investment was made.</p>	

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
		formed or a compliance statement was submitted.			
	<p>The investment in the company must be held for at least three years.</p> <p>Tax relief will be lost if during this three-year period the investor becomes a connected party of the company.</p> <p>Tax relief will be lost if: all of the shares are sold by the investor within three years of the investment; the company fails to meet the conditions for the scheme; the investor receives money, other assets or unusually high interest on a loan from the</p>	<p>The investment in the company must be held for at least three years.</p> <p>Tax relief will be lost if during this three-year period the investor becomes a connected party of the company.</p> <p>Tax relief will be lost if: all of the shares are sold by the investor within three years of the investment; the company fails to meet the conditions for the scheme; the investor receives money, other assets or unusually high interest on a loan from the</p>	<p>The investment in the company must be held for at least three years.</p> <p>Tax relief will be lost if during this three-year period the investor becomes a connected party of the company.</p> <p>Tax relief will be lost if: all of the shares are sold by the investor within three years of the investment; the company fails to meet the conditions for the scheme; the investor receives money, other assets or unusually high interest on a loan from the</p>	<p>The investment in a VCT must be held for at least five years.</p> <p>Tax relief will be lost on those shares that stop qualifying during this five-year period.</p> <p>Tax relief will not be forfeited if the investor gains a connection with the VCT or a company it is invested in.</p>	

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
	company or the company pays back money invested in shares to investors who have not received tax relief.	company or the company pays back money invested in shares to investors who have not received tax relief.	company or the company pays back money invested in shares to investors who have not received tax relief.		
	Relief can be claimed up to five years after the 31 January following the tax year in which the investment was made.	Relief can be claimed up to five years after the 31 January following the tax year in which the investment was made.	Relief can be claimed up to five years after the 31 January following the tax year in which the investment was made.	Relief can be claimed up to four years after the 31 January following the tax year in which the investment was made.	
	An investor is connected to the company if the investor and associates of the investor are employed by the company or any subsidiary (an exception exists for a director in some cases). They are also connected where the investor or associates of the investor owns	An investor is connected to the company if the investor and associates of the investor are employed by the company or any subsidiary (an exception exists for a director in some cases). They are also connected where the investor or associates of the investor owns	An investor is connected to the company if the investor and associates of the investor are employed by the company or any subsidiary (an exception exists for a director in some cases). They are also connected where the investor or associates of the investor owns	An investor is connected to the company if the investor and associates of the investor are employed by the company or any subsidiary (an exception exists for a director in some cases). They are also connected where the investor or associates of the investor owns	

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
	more than 30% in total of the company's shares, rights to assets if the company is wound-up, voting rights or loan capital for SITR.	more than 30% in total of the company's shares, rights to assets if the company is wound-up, voting rights or loan capital for SITR.	more than 30% in total of the company's shares, rights to assets if the company is wound-up, voting rights or loan capital for SITR.	more than 30% in total of the company's shares, rights to assets if the company is wound-up, voting rights or loan capital for SITR.	
Tax incentive: Capital gains tax relief	CGT relief on gain on disposal of any assets if proceeds are used to invest in SEIS. Relief is 50% of investment (up to £100,000) exempt from tax, (maximum amount of relief is £50,000).	CGT relief on gain on disposal of any assets if proceeds are used to invest in SITR. 100% of investment deferred if used to buy new shares in another SITR (limited to investments of up to £1 million.)	CGT relief on gain on disposal of any assets if proceeds are used to invest in EIS. 100% of investment is deferred if used to buy new shares.	N/a	
	Capital gain on disposal of shares is exempt from tax if the investor received Income Tax relief on that investment which has not been reduced or withdrawn at a later date and the shares have been held	Capital gain on disposal of shares is exempt from tax if the investor received Income Tax relief on that investment which has not been reduced or withdrawn at a later date and the shares have been held	Gains exempt from CGT when shares are sold if the investor received Income Tax relief on that investment which has not been reduced or withdrawn at a later date (exception exists where it has been	Gains exempt from Capital Gains Tax when shares are sold. This is applicable to newly issued and previously owned (second owner) shares.	Disregard capital gain if shares are held for at least 12 months but less than 10 years. If shares are held for longer than 10 years, capital gains tax only

	SEIS (UK)	SITR (UK)	EIS (UK)	VCT (UK)	ESIC (Australia)
	for at least three years.	for at least three years.	withdrawn due to investor becoming a connected person) and the shares have been held for at least three years.		applicable on the growth of the market value determined in the tenth year (disregard therefore growth on initial investment in first ten years).
	Relief available for capital losses against income.	Relief available for capital losses against income but not on loans.	Relief available for capital losses against income. <i>The loss relief is at the equivalent rate to the highest rate of income tax payable by the taxpayer.</i> <i>Example of calculation of loss relief on investment of £10,000:</i> <i>(£10 000 – 30% Income Tax relief claimed) x 45% = £3 150.</i>	N/a	Disregard capital loss if shares have been held for less than 10 years.

Table 10: Equity crowdfunding regulation (Own construct)

MODEL	USA	UK	AUSTRALIA	NEW ZEALAND
EQUITY				
<i>Legislative amendments</i>	Introduced by the Jumpstart Our Business Startups Act 2016 (USA) (JOBS Act) and Regulation Crowdfunding	Introduced additional rules in the 2014PS14/4 Policy Statement. Revised the rules within the FCA Handbook	Amended the Corporations Act	Amended the Financial Markets Conduct Act 2013
<i>Monitoring body</i>	Financial Industry Regulatory Authority	Financial Conduct Authority (FCA)	Australian Securities and Investments Commission (ASIC)	Financial Markets Authority (FMA)
<i>Issuer cap</i>	Aggregate amount of securities sold can't exceed \$1 070 000 during the 12-month period preceding the date of the offering.	Not applicable	Aggregate amount of securities sold can't exceed \$5 million during the 12-month period preceding the date of the offering.	Aggregate amount of securities sold can't exceed NZ\$2 million during the 12-month period preceding the date of the offering.
<i>Investor cap</i>	If net worth or annual income of investor is less than \$107 000: <ul style="list-style-type: none"> the greater of \$2 200 or 5% of the lesser of the net worth or annual income. If net worth and annual income is \$107 000 or more: <ul style="list-style-type: none"> invest up to 10% of the lesser of the net worth or annual income (total investment is limited to \$107 000). 	Non-sophisticated investors can't invest more than 10% of net investable assets.	Retail clients can't invest more than \$10 000 in any 12 months in the same company.	Not applicable

It is evident that South Africa is lagging behind in the development of crowdfunding when compared with countries such as the USA, UK, Australia and New Zealand. These countries have already amended their regulations to allow crowdfunding in order to remain competitive in the global market.

The UK and Australia provide tax incentives to encourage crowd investing. From Table 9, it is evident that the tax incentives provided in these two countries are similar to a certain extent. The tax incentive is in the form of a tax credit and not a tax deduction. The incentives provided in the UK are under provisions for different stages of funding required by a company, namely SEIS, EIS and VCT. There is also a separate incentive for investing in a SITR. As was seen from the comparison of the provisions (Table 7), these are written in a similar way, thereby simplifying the understanding of the provisions.

For donation-based crowdfunding, a deduction is only available if the donation is made to a qualified charity. There is therefore no deduction for a donation made to assist an entrepreneur who wants to use crowdfunding in order to start a business.

The policy considerations underpinning crowdfunding in South Africa will be discussed in the next chapter.

CHAPTER 5: POLICY CONSIDERATIONS UNDERPINNING CROWDFUNDING IN SOUTH AFRICA

5.1 INTRODUCTION

The role of the tax system cannot be seen in isolation since the tax system is integrated with the broader fiscal and macro-economic policy as well as with the political system of the government (Davis Tax Committee, 2016:8). The Davis Tax Committee was formed on 17 July 2013, following the then Minister of Finance's announcement in his 2013 Budget Speech that a tax review committee would be initiated to assess South Africa's tax policy framework (Gordhan, 2013:21). The aim of the review was to determine whether the tax policy supports the government's objectives of inclusive growth, employment, development and fiscal sustainability (Gordhan, 2013:21). It is therefore important that, in designing a tax framework for crowdfunding transactions in South Africa, the framework meets and supports the objectives and policy goals of the government. The policy objectives of the government are contained in a number of reports, some which are referred to below.

5.2 THE NATIONAL DEVELOPMENT PLAN VISION FOR 2030

The National Development Plan Vision for 2030 (NDP), which was released in August 2012, aims to eliminate poverty and to reduce inequality in South Africa by 2030 through accelerated economic growth (South Africa. National Planning Commission, 2011:1). As previously stated, the importance of small businesses, to create employment opportunities and to transform business ownership, is acknowledged in the NDP (South Africa. National Planning Commission, 2011:117). Employment is encouraged through economic growth since South Africa has a high unemployment rate which was 27.6% in the first quarter of 2019 (Statistics South Africa, n.d.). The government intends to decrease unemployment and to increase growth of the economy by means of the following (South Africa. National Planning Commission, 2011:12), amongst other things:

- Improving the coordination of activities in small business agencies, development finance institutions, and public and private incubators in order to support small businesses.
- Increasing investment in social and economic infrastructure to lower costs, raise productivity and bring more people in the mainstream of the economy.
- Reducing the regulatory burden in sectors where the private sector is the main investor, such as broadband Internet connectivity, to achieve greater capacity and lower prices.

The government further aims to raise rates of investments from the following sources (South Africa. National Planning Commission, 2011:105-106):

- Higher levels of public-sector fixed capital formation especially in the earlier years, with an emphasis on infrastructure that promotes efficiency and reduces costs.
- Stimulate private investment by expanding consumer markets, increasing profitability, natural resources endowments and leveraging the SA's position on the continent. This will be obtained through creating better conditions through policy certainty, infrastructure delivery, efficiency of public services and the quality of labour.
- Foreign investment will be encouraged due to the limited savings available in SA. Such investments will raise productivity and incomes which will decrease the unemployment rate and will increase savings. The aim is to fund most investments domestically over time.

The NDP therefore acknowledges the importance of small businesses and private investment in order to encourage economic growth and to ultimately decrease the unemployment rate. The government aims to reduce the regulatory burden in sectors where the private sector is the main investor and aims to attract private investment through improved conditions created as a result of policy certainty. As stated earlier,

there is currently not always policy certainty regarding the tax consequences of some crowdfunding transactions.

5.3 THE WORLD BANK'S REPORT: SOUTH AFRICA'S COUNTRY-LEVEL FISCAL POLICY NOTES: SECTOR STUDY OF EFFECTIVE TAX BURDEN AND EFFECTIVENESS OF INVESTMENT INCENTIVES IN SOUTH AFRICA – PART I

On request of the Davis Tax Committee in August 2014, the World Bank Group conducted a study to determine the effectiveness of investment incentives of the South African tax system, on encouraging investment (World Bank, 2015:12). The report focused on eight sectors which included manufacturing, agriculture, tourism, different services and mining sectors and measured the Marginal Effective Tax Rates (METR) on capital and labour for these sectors. The report explains that the METR "...is a measure of the burden of tax on investment for a profit maximizing firm and determines the scale of a project: a higher METR means small size projects and fewer investment. As a result, the METR is an important parameter to keep in mind when designing tax policy" (World Bank, 2015:13-14). The METR is basically calculated as the ratio of the difference in the rate of return on the marginal investment before taxes and after taxes to the rate of return on the marginal investment before taxes (World Bank, 2015:16). The focus was mainly on tax incentives in the form of investment allowances (World Bank, 2015:18).

It was found that the METR on capital is lower than the 28% statutory tax rate applicable to companies in South Africa. However, incentives such as the accelerated depreciation allowances, investment allowances and interest deductibility considerably reduce the effective tax burden to less than the 28% (World Bank, 2015:9). It was stated in the report that the deductibility of interest is globally a major tax policy issue and that the Mirrlees Commission (which conducted a review of the UK tax system (refer to section 5.5)) even recommended a deduction for equity at the risk free rate of interest to prevent bias of economic decisions (World Bank, 2015:33).

An important finding in the report (derived from interviews with sectoral players) was that investment in South Africa is generally not constrained by the tax system. Obstacles to investment were primarily issues related to the business environment in South Africa such as the reliability of electricity supply, labour relations and policy uncertainty (World Bank, 2015:10).

5.4 THE DAVIS TAX COMMITTEE'S REPORT: MACRO ANALYSIS OF THE TAX SYSTEM AND INCLUSIVE GROWTH IN SOUTH AFRICA

The final report on the Macro Analysis of the Tax System and Inclusive Growth in South Africa was released by the Davis Tax Committee during April 2016. It was stated that the main challenge of the South African tax system is to raise revenue in conjunction with supporting economic growth that would stimulate employment and reduce poverty and inequality (Davis Tax Committee, 2016:102). One of the aims of the report was to propose a broad conceptual framework for analysing the role of the tax system in support of inclusive growth, employment, development, equity and fiscal sustainability in South Africa (Davis Tax Committee, 2016:5). These objectives are in line with the NDP as stated above.

In designing tax policy to achieve government objectives, the following principles should be adhered to (Davis Tax Committee, 2016:14):

1. Efficiency: Sufficient income should be raised through the tax system without distorting the economy (Davis Tax Committee, 2016:14). This implies neutrality in the tax system, where the decisions of the taxpayer must not be influenced predominantly by the more favourable tax treatment of one type of transaction above the other.
2. Equity: Every citizen has to contribute to the income of the government in proportion to their ability and capacity to do so (Davis Tax Committee, 2016:14). This is also referred to as the ability-to-pay principle. Both horizontal and vertical equity are important. Vertical equity is achieved in SA with the progressive tax table where taxpayers earning more, contribute more towards the income tax

since such persons have a greater ability to pay. In achieving horizontal equity, taxpayers with similar income amounts should be taxed at the same rate, regardless of the source of their income. Where appropriate, tax equity should also consider the benefits of the public good received vs the tax burden imposed (Davis Tax Committee, 2016:14).

3. **Simplicity:** Taxes should be designed in a manner that is easy to understand and apply and should be collected at a time and in a manner that is convenient to the taxpayer (Davis Tax Committee, 2016:14). It is submitted that, by simplifying the tax system, the costs of compliance are minimised.
4. **Transparency and certainty:** The calculation of tax liabilities as well as the manner in which taxes are collected should be certain. It is important that tax rules and procedures are transparent and are applied consistently (Davis Tax Committee, 2016:14).
5. **Tax buoyancy:** Tax buoyancy refers to the relationship between the tax system and the economy of a country. The tax system should be able to adjust in response to changes in the economic environment. (Davis Tax Committee, 2016:14).

Adam Smith first laid down the four maxims of a good tax system in 1776 (Smith, 1776:639). The above principles are therefore well-known and are globally applied. It was furthermore acknowledged by the Davis Tax Committee that perceptions of fairness of the tax system is of utmost importance to the willingness of citizens to pay taxes. The Committee therefore emphasised the importance of transparency and participation by taxpayers in the development of tax policy (Davis Tax Committee, 2016:9).

5.5 THE MIRRLEES COMMISSION

In 2011, the Mirrlees Commission conducted a review of the UK tax system in general on instruction of the Institute of Fiscal Studies (IFS) (Mirrlees *et al.*, 2011:v). The main purpose of the review was to “identify the characteristics that would make for a good tax system in an open economy in the 21st century and to suggest how the British tax

system in particular might be reformed to move closer to that ideal” (Mirrlees *et al.*, 2011:v). The Commission furthermore tried to ensure that the conclusions were relevant internationally (Mirrlees *et al.*, 2011:v). The findings of the report might therefore also be relevant to the South African tax system. The Commission made the following suggestions, amongst others, which were considered relevant in a South African context:

- The overall tax rates applied to income from employment, self-employment and distributed profits (such as dividends) need to be aligned much more closely (Mirrlees *et al.*, 2011:451, 462). This implies that the combined rates of corporate and shareholder taxation should equal the tax rates levied on employment and other sources of income (Mirrlees *et al.*, 2011:474). The motivation for this recommendation is that small businesses will be structured differently and one legal form might be favoured above another if the tax treatment of income derived from the above activities differs substantially (Mirrlees *et al.*, 2011:451-452). By implementing this recommendation, it will furthermore discourage a shift from economic activity away from employment by, for example, contracting with personal service providers (Mirrlees *et al.*, 2011:461-462).
- Targeted tax measures should be used for small businesses instead of lower tax rates for all profits of all small businesses (Mirrlees *et al.*, 2011:469). This will limit the need for anti-avoidance provisions to prevent small companies being established merely to take advantage of a reduced tax rate (Mirrlees *et al.*, 2011:463).
- Deductions should be allowed for expenditure incurred in producing income, and this principle should also be applied to saving and investment (Mirrlees *et al.*, 2011:474). The rationale for this recommendation is that, in generating future income (such as interest), current consumption is being sacrificed and failing to allow these deductions distorts economic decisions (Mirrlees *et al.*, 2011:474). The Commission recommended that a deduction should be allowed each year for the opportunity cost of capital previously saved or invested (Mirrlees *et al.*, 2011:475). For savings, this is referred to as the rate-of-return allowance (RRA)

treatment and for business investment (investment in equity) it is referred to as the allowance for corporate equity (ACE) (Mirrlees *et al.*, 2011:475). Allowing a deduction for both investment and equity finance would eliminate the bias in favour of debt over equity finance (Mirrlees *et al.*, 2011:492).

5.6 THE ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

The Organisation for Economic Co-operation and Development (OECD):

provides a forum in which governments can work together to share experiences and seek solutions to common problems. It works with governments to understand what drives economic, social and environmental change. It measures productivity and global flows of trade and investment. It analyses and compares data to predict future trends. It sets international standards on a wide range of things, from agriculture and tax to the safety of chemicals⁹⁰ (OECD, n.d).

Various studies have been conducted globally by the OECD in order to encourage small business development. In a report published by the OECD, *G20/OECD High-level principles on SME Financing*, it was again emphasised that SMEs are important for innovation, growth, job creation and social cohesion in a country but are disadvantaged when compared with large firms when accessing finance (OECD, 2015:1). Consequently, the OECD provides the following eleven high-level principles on SME financing which should be used as guidelines by countries for the development of policy strategies for SME financing (OECD, 2015:2):

1. The financing needs and gaps of SMEs should be identified and the evidence base should be improved.
2. The access of SMEs to traditional bank financing should be strengthened.

⁹⁰ <https://www.oecd-ilibrary.org/oecd/about> (Accessed 29 April 2020).

3. SMEs should be allowed to access diverse non-traditional financing instruments and channels.
4. Financial inclusion should be promoted for SMEs and access to formal financial services, including for informal firms, should be made easier.
5. Regulation should be designed that supports a variety of financing instruments for SMEs, while ensuring financial stability and investor protection.
6. Transparency should be improved in SME finance markets.
7. The financial skills and strategic vision of SMEs should be improved.
8. Principles of risk sharing for publicly supported SME finance should be adopted.
9. Timely payments should be encouraged in commercial transactions and public procurement.
10. Public programmes should be designed for SME finance which ensure additionality, cost effectiveness and user-friendliness.
11. Public programmes to enhance SME finance should be monitored and evaluated.

It is evident from the above principles that the OECD encourages countries to develop policies which will give SMEs access to a range of options for access to finance. It is furthermore stated by the OECD (2015:6) that regulatory certainty is needed for such alternative financing instruments and that undue administrative burdens and red tape should be minimised while maintaining investor protection, integrity of market participants, corporate governance and transparency. It is explicitly stated by the OECD that “legal, tax and regulatory frameworks (including tax policies which provide incentives to encourage both debt and equity financing) should contribute to foster diverse sources of finance” (OECD, 2015:6).

5.7 CONCLUSION

The South African government aims to decrease unemployment by encouraging small business creation and growth. Since funding is one of the main constraints of small businesses, crowdfunding is an alternative funding source for small businesses. Crowdfunding is a relatively new source of funding and regulators have started to

implement specific regulations globally to regulate crowdfunding, mainly by aiming to be either effective or inclusive, or both.

One area that should also be considered is the tax implications of crowdfunding transactions. Some countries have specific tax incentives to encourage debt and/or equity crowdfunding. However, no such specific tax incentives are currently available in South Africa and the tax implications of some crowdfunding transactions are not always certain.

It is important that, in designing or evaluating tax legislation for crowdfunding transactions in South Africa, the aims and policy objectives, namely to reduce the regulatory burden for small businesses and to stimulate private investment by ensuring policy certainty of the government, are supported. It is furthermore important that the principles of a good tax system of efficiency, equity, simplicity, transparency, certainty and tax buoyancy be complied with in designing specific tax legislation for crowdfunding transactions.

Since crowdfunding is an international phenomenon that extends over continents because of the use of the Internet, the recommendations of the Mirrlees Commission and the OECD should also be considered in designing tax legislation for crowdfunding transactions. Bias in the tax treatment in favour of debt over equity finance or in favour of one entity/person above another should be avoided as far as possible, to avoid distortion of economic activity.

The goals of the government as contained in the NDP are linked to the principles of a good tax system, the recommendations by the Mirrlees Commission and the principles of the OECD in Table 11.

Table 11: Summary of policy considerations (Own construct)

Davis Tax Committee	NDP	Mirrlees Commission	OECD
<p>Efficiency: Generate sufficient income with minimum distortions to the economy. Decisions should not be predominantly influenced by the tax implications.</p>	<ul style="list-style-type: none"> • Support small businesses through better coordination of activities in small business agencies, development finance institutions, and public and private incubators. • Increase investment in social and economic infrastructure to lower costs, raise productivity and bring more people into the mainstream of the economy. 	<ul style="list-style-type: none"> • Targeted tax measures should be used for small businesses instead of lower tax rates for all profits of all small businesses. • The overall tax rates applied to income from employment, self-employment and distributed profits (such as dividends) need to be aligned much more closely. • Deductions should be allowed for expenditure incurred in producing income and this principle should also be applied to saving and investment. 	<ul style="list-style-type: none"> • Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection. • Adopt principles of risk-sharing for publicly supported SME finance. • Encourage timely payments in commercial transactions and public procurement. • Monitor and evaluate public programmes to enhance SME finance.
<p>Equity: Every citizen has to contribute to the income of the government in proportion to their ability and capacity to do so.</p>			<ul style="list-style-type: none"> • Strengthen SME access to traditional bank financing. • Enable SMEs to access diverse non-traditional financing instruments and channels. • Promote financial inclusion for SMEs and ease access to formal financial services, including for informal firms.
<p>Simplicity: Taxes should be designed in a manner that is easy to understand and apply and should be collected at a time and in a manner that is convenient to the taxpayer.</p>	<ul style="list-style-type: none"> • Reduce the regulatory burden in sectors where the private sector is the main investor, such as broadband Internet connectivity, to achieve greater capacity and lower prices. 		<ul style="list-style-type: none"> • Enhance SME financial skills and strategic vision. • Design public programmes for SME finance which ensure additionality, cost effectiveness and user-friendliness.

Davis Tax Committee	NDP	Mirrlees Commission	OECD
<p>Transparency and certainty: The calculation of tax liabilities as well as the manner in which taxes are collected should be certain and transparent.</p>			<ul style="list-style-type: none"> • Identify SME financing needs and gaps and improve the evidence base. • Improve transparency in SME finance markets.
<p>Tax buoyancy: The tax system should be able to adjust in response to changes in the economic environment.</p>			

The current ITA provisions of South Africa will be discussed in the next chapter. This will be done in order to determine whether the policy considerations discussed in this chapter are supported by the current income tax legislation pertaining to crowdfunding.

CHAPTER 6: AN EVALUATION OF THE CURRENT INCOME TAX PROVISIONS IN SOUTH AFRICA

6.1 INTRODUCTION

The objectives and policy goals of the government are aimed at stimulating the small business sector in order to aid in job creation. As was seen in Chapter 4, crowdfunding is typically subject to taxation and eligible for some deductions internationally if goods or services are received as a reward for the funding provided and funding is therefore not an act of pure gratuitousness.

Applicable taxes includes *inter alia* income tax, capital gains tax and value-added tax. The focus of this study is on the income tax consequences. The current South African income tax consequences of the different crowdfunding models are discussed below. The income tax consequences are furthermore considered in the light of the policy goals of the government, as set out in Chapter 5, to determine whether they support the policy goals of the government as well as internationally accepted principles of a good tax system.

6.2 EXISTING INCOME TAX PROVISIONS APPLICABLE TO INVESTMENT IN SMALL BUSINESSES

The Davis Tax Committee (DTC), issued a First Interim Report on Small and Medium Enterprises in 2014. The aims of the government, as set out in the NDP, are valued and it is stated in that report that the DTC “seeks to prioritise the examination of the tax system and its impact upon the promotion of small and medium size businesses including an analysis of tax compliance costs, a possible streamlining of tax administration, the simplification of tax legislation and the role of incentives” (Davis Tax Committee, 2014:5).

There is not a universal definition of what a small and medium-sized business is and the NDP, the National Small Business Act, 1996 (Act No. 102 of 1996) and the Income Tax

Act, 1962 (Act No. 58 of 1962), all contain their own interpretations and definitions. The DTC illustrates the range of entities that fall within the applicable definitions in the figure below, with reference to the “missing middle” as entrepreneurial businesses with growth potential:

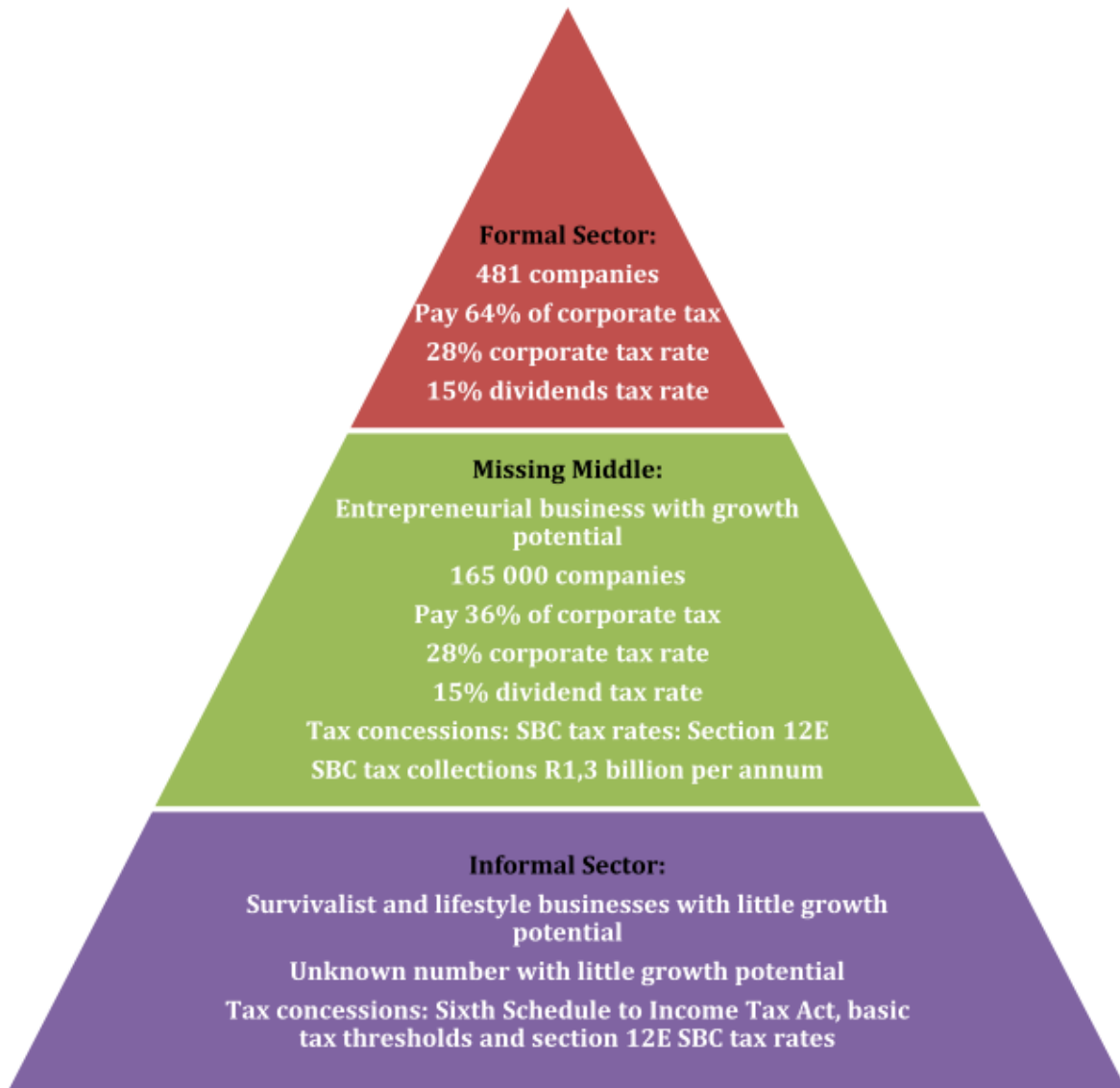


Figure 8: The missing middle (Davis Tax Committee, 2014:9)

There are a number of existing provisions in the ITA affecting investment in small businesses. These provisions are discussed below.

6.2.1 Small business funding entities

Before the introduction of small business funding entities in 2015, the provision of support and financial assistance to micro enterprises qualified for relief only if such activity qualified as a public benefit activity in the Ninth Schedule of the ITA or if amounts were invested through the VCC regime. Therefore, any activity provided to SMMEs that did not fall under the provisions of a VCC or PBO, would not have qualified for relief in terms of the ITA.

Provisions for small business funding entities (SBFE) that were introduced in the ITA from 1 March 2015 are similar to provisions applicable to a PBO. An SBFE is defined in section 30C(1) of the ITA as a trust, an association of persons or a non-profit company as defined in section 1 of the Companies Act, that has been incorporated, formed or established in the Republic. The sole or principle objective of the entity should be the provision of funding for small, medium and micro-sized enterprises. The funding should:

- be provided for the benefit of, or should be widely accessible to small, medium and micro-sized enterprises;
- be provided on a non-profit basis and with an altruistic or philanthropic intent; and
- not be intended to directly or indirectly promote the economic self-interest of any fiduciary or employee of that entity, otherwise than by way of reasonable remuneration payable to that fiduciary or employee⁹¹.

Section 10(1)(cQ) of the ITA exempts the receipts and accruals of any SBFE in full from normal tax to the extent that the receipts and accruals are derived otherwise than from any business undertaking or a trading activity. The receipts and accruals are also exempt if they have been received from a business undertaking or trading activity if the undertaking or trading activity is integral and directly related to the sole or principal objective of that SBFE, is carried out or conducted on a basis substantially the whole of

⁹¹ Section 30C(1)(b) of the Income Tax Act of 1962.

which is directed towards the recovery of cost and does not result in unfair competition in relation to taxable entities⁹². The requirements for exemption as set out in section 10(1)(cQ) are the same as the requirements for exemption of a PBO in section 10(1)(cN) (see section 6.3.1).

Dividends in respect of which an SBFEE is the beneficial owner, are exempt from dividends tax in terms of section 64(1)(F)(i). Furthermore, in terms of paragraph 63B of the Eighth Schedule of the ITA, assets used by an SBFEE are exempt from capital gains tax upon its disposal by the SBFEE to the extent that such assets were used in lending business of the SBFEE for the benefit of small, medium and micro-sized enterprises. Donations made to and donations made by the SBFEE are exempt from donations tax, similar to that to or by a PBO⁹³.

If funding is received by a small, medium or micro-sized enterprise⁹⁴ from an SBFEE, section 10(1)(zK) exempts such amounts from normal income tax of a small, medium or micro-sized enterprise. However, section 23O determines that, where such funds were used to acquire trading stock or an allowance asset, any expenditure incurred in respect of trading stock allowed as a deduction in terms of section 11(a) or any amount taken into account in respect of the value of trading stock or the base cost of an allowance asset, must be reduced to the extent that the amount received or accrued from the SBFEE is applied for that purpose. If the funds were not used to fund trading stock or an allowance asset, the amount claimed as a deduction in terms of section 11 for that year of assessment must be reduced to the extent of the amount received or accrued from the SBFEE. The excess (the extent to which the amount received or accrued exceeds the amount allowed to be deducted under section 11) is deemed to be an amount received or accrued from an SBFEE in the following year of assessment⁹⁵.

⁹² Section 10(1)(cQ)(ii) of the Income Tax Act of 1962.

⁹³ Section 56(1)(h) of the Income Tax Act of 1962.

⁹⁴ A small, medium or micro-sized enterprise is defined in section 1 as any person that qualifies as a micro business as defined in paragraph 1 of the Sixth Schedule or any person that is a small business corporation as defined in section 12E(4).

⁹⁵ Section 23O(6) of the Income Tax Act of 1962.

It is therefore possible for an intermediary (platform) in a crowdfunding transaction to be an SBFEE. Funding received by the crowdfunding project creator (the small, medium or micro-sized enterprise (SMME)) will then not be taxable in the hands of the SMME. This is beneficial to the SMME since the funding is received tax-free and can be used to fund the start-up or running expenses of the business. Section 23O further determines that no tax deduction can be claimed in the form of capital allowances (if an asset was purchased) or a general deduction under section 11 by the SMME to the extent that such funding was used to fund that expense or asset, thereby limiting the erosion of the tax base.

However, the ITA does not make provision for a tax deduction for a funder who has provided the funds to the SBFEE. This is in contrast to contributions made to a qualifying PBO for which the funder can claim a possible tax deduction in terms of section 18A (see section 6.3.1). The funder of an SBFEE will therefore only be able to claim such a contribution as a deduction, if the requirements of section 11(a) and 23(g) are met (refer to section 6.3.1 for a discussion of the requirements of section 11(a)).

6.2.2 Small business undertakings

Section 37G of the ITA was inserted by section 24 (1) of Act No. 21 of 1995 and makes provision for the Minister of Finance to issue regulations to facilitate compliance with the provisions of the ITA by natural persons who carry on business through small business undertakings. Such regulations may then authorise variation of any provision of the ITA relating to the determination of the taxable income derived from such undertaking. There is, however, no definition of what a small business undertaking is and no regulation could be found in this regard.

6.2.3 Venture capital companies

It is also admitted in the External Guide Venture Capital Companies that access to equity finance is one of the main challenges to the economic growth of small and medium-sized businesses (South African Revenue Services, 2012:4). Specific ITA

provisions were introduced in 2009 in section 12J of the ITA to provide tax incentives for investors investing in a venture capital company (hereafter referred to as a VCC).

A VCC is an investment vehicle through which a number of investors can fund a portfolio of business interests. The VCC is intended to be a marketing vehicle that attracts retail investors. Small investors are brought together and thereby investment expertise is concentrated in favour of the small business sector. The VCC merely acts as a financier (e.g. angel investor) to various independent small businesses and start-ups and may not control a qualifying investee company (SA National Treasury, 2008:67-68).

Section 12J of the ITA provides for a deduction to the investors for the amount expended in purchasing the shares in the VCC. Where any loan or credit is used to finance the expenditure in acquiring a venture capital share and remains owing at the end of the year of assessment, the deduction is limited to the amount for which the taxpayer is deemed to be at risk on the last day of the year of assessment⁹⁶. A person is deemed to be at risk for the purpose of this provision to the extent that the person incurred expenditure to acquire the shares or to the extent that the repayment of the loan is used by the taxpayer for the payment or financing of any expenditure incurred in acquiring the shares⁹⁷. The deduction is limited annually to R5 million for a company and R2.5 million for a person other than a company⁹⁸. This VCC incentive is only applicable to the investor who has purchased equity shares in the VCC. The VCC, in turn, will then invest in various other qualifying companies.

There will be no recoupment of the deduction granted if the shares are sold after five years⁹⁹. If, after a period of 36 months commencing on the first date of the issue of the venture capital shares, a taxpayer is a person connected to the VCC, no deduction will be allowed. In addition, no deduction will be allowed where the taxpayer holds, at the

⁹⁶ Section 12J(3(a)) of the Income Tax Act No. 58 of 1962.

⁹⁷ Section 12J(3(b)) of the Income Tax Act No. 58 of 1962.

⁹⁸ Section 12J(3C) of the Income Tax Act No. 58 of 1962.

⁹⁹ Section 12J(9) of the Income Tax Act No. 58 of 1962.

end of any year of assessment following the expiry of a period of 36 months commencing on the first date of the issue by the VCC of VCC shares of any class, more than 20% of the VCC shares of that class¹⁰⁰. The company will furthermore be required to include in its income an amount equal to 125% of the expenditure incurred by any person to acquire shares issued by that company.

The main differences between investments that will qualify for this incentive and crowdfunding investments are the following:

- With investment through a VCC, the investor does not invest directly into the company but invests through the VCC. With crowdfunding, the investor invests directly into the project that requires funding.
- The investment through a VCC requires that shares be bought in the VCC. The investor will receive shares with equity crowdfunding but not with the other types of funding done through crowdfunding (donation-based, rewards-based, pre-purchase or the debt-based models).

Furthermore, the limitations and requirements for a company to qualify as a VCC, as set out in section 12J of ITA, are of such a nature that smaller projects requiring funding will not meet the requirements of section 12J and thereby, the investors will not qualify for the VCC tax incentive. With the exception of certain bigger projects funded through the equity-based model in some cases, not all projects requiring funding will necessarily have registered a company, thereby also not qualifying for the relief available in section 12J of the ITA.

This incentive is, however, subject to a so-called sunset clause and is only available until 30 June 2021. The purpose of this sunset clause is to provide an opportunity to evaluate the effectiveness of the VCC (SA National Treasury, 2008:68). Crowdfunding is aimed at entrepreneurs who do not have access to funding from venture capitalists or angel investors and is therefore not a substitute for those sources of finances (Bradford, 2012:104).

¹⁰⁰ Section 12J(3A) of the Income Tax Act No. 58 of 1962.

6.2.4 Small business corporations

Section 12E of the ITA provides for accelerated capital allowance deductions in respect of assets purchased by a small business corporation. A small business corporation is furthermore taxed based on a favourable progressive tax scale and not a flat rate of 28%, which applies to other companies.

A small business corporation is defined in section 12E(4)(a) of the ITA and contains various requirements which must be met before the entity can be classified as a small business corporation for tax purposes. The requirements include that the entity should be a private company, a close corporation, a co-operative or personal liability company; the gross income for the year of assessment must not exceed R20 million and the shareholders or members of the entity must all be natural persons. The individual shareholders are furthermore not allowed to have shares in other companies (subject to certain exceptions such as shares in a company that did not trade in that year of assessment and of which the assets are R5 000 or less or if they are listed shares).

The type-of-entity requirement does not appear to be problematic since most small businesses can register as a private company without incurring excessive costs. The gross income limit of R20 million is also not that restrictive for an upcoming small business. However, the restrictions on the shareholders might limit the application of this section to only a few small businesses. The DTC also acknowledges this as a problem. According to the DTC, this provision is intended to prevent the multiple ownership of SBCs by one taxpayer (Davis Tax Committee, 2014:19). It is suggested by the DTC that this burdensome provision could be simplified if it were amended to only exclude a SBC where any shareholder holds any interest in any other SBC (Davis Tax Committee, 2014:19).

An entrepreneur is defined as:

...an individual who creates a new business, bearing most of the risks and enjoying most of the rewards. The entrepreneur is commonly seen as an

innovator, a source of new ideas, goods, services, and business/or procedures. Entrepreneurs play a key role in any economy, using the skills and initiative necessary to anticipate needs and bring good new ideas to market. Entrepreneurs who prove to be successful in taking on the risks of a startup are rewarded with profits, fame, and continued growth opportunities. Those who fail, suffer losses and become less prevalent in the markets. (Hayes, 2020)

Entrepreneurs might have other private companies in which they carry on another entrepreneurial business and in which they own shares. Having more than one company (legal entity) might be a good business decision to limit one's liability of losses and is therefore not irregular. However, this will disqualify all of the entrepreneur's private companies from being small business corporations since the entrepreneur will then own shares in other private companies as well. The limitation on the shareholding of natural persons might therefore be problematic for entrepreneurs and might result in the relief provision provided in section 12E not being utilised as intended when introduced into legislation. It is submitted that simplifying it to exclude any SBC where any shareholder holds any interest in any other SBC (as suggested by the DTC), will not be effective since it will still be very restrictive, excluding numerous small businesses from utilising section 12E. It is therefore proposed that this requirement should rather be amended to allow shareholding in other private companies, as long as such shareholding is less than 50% in each of such other private companies. This will enable entrepreneurs to have more than one entrepreneurial venture and to utilise the tax incentives to such small businesses which will in turn enable them to grow and to generate employment opportunities.

6.3 EXISTING INCOME TAX ACT PROVISIONS ADDRESSING CROWDFUNDING

While there are tax consequences for the creator and the funder, there are no specific provisions contained in the ITA referring explicitly to crowdfunding. The effect of existing ITA provisions on crowdfunding is discussed below and depends on the crowdfunding model used.

6.3.1 Donation and rewards model

With the donation model, the funder (donor) donates an amount to the crowdfunding project. The donation model normally involves an element of charity or generosity since the funder simply donates money to the project or company without expecting any financial or other tangible benefit in return. The donation might, however, offer the funders the opportunity to get connected with the creator or to use the donation for advertising purposes.

The rewards model is similar to the donation model and these two models are often used simultaneously. In the rewards model, the funder is rewarded for the investment. With this model, there is normally a significant time lapse between the investment and the receiving of the reward. This is especially the case where the project creator requires funding in order to manufacture the project.

The reward may be in various forms such as simply recognition, or a tangible benefit (asset) such as the first specimen of the product developed by the project creator, or even in the form of a service to be rendered by the project creator. If the reward is in the form of a product, the crowdfunding model is referred to by some researchers as the pre-purchase model.

6.3.1.1 Regulatory requirements

Donation-based crowdfunding is unlikely to fall within in the current legal regulation of consumer protection or financial services (as referred to under section 6.3.3.1 below). Laws dealing with consumer protection and competition may apply to rewards-based crowdfunding where a product is sold and the crowdfunding is therefore a pre-purchase arrangement. A discussion of such laws is beyond the scope of this study but mindfulness of these legal obligations and possible implications is required by such crowdfunding models. It was found in a case before the Tax Court (*IT 24510*) in 2019, that the provisions of the Consumer Protection Act No 68 of 2008 (CPA) (South Africa, 2008) cannot be ignored when determining the tax consequences. According to the

gross income definition in section 1 of the ITA, an amount which has been received should be included in gross income on the earlier of date of receipt or accrual (see section 6.3.1.2). In *IT 24510*, gift cards were sold by a taxpayer (retailer of clothing, comestibles and general merchandise) as part of the facilities offered to its customers. The SARS aimed to include the amount of all unredeemed gift cards, in the year of issue of the gift cards to the customers, based on the principle that the amount was received by the taxpayer for his/her own benefit on the date of issue of the cards¹⁰¹. The court held that, based on section 63 and section 65 of the CPA, the moneys could not legally have become the property of the gift card bearer at the date of issue.

Section 63(3) of the CPA determines that consideration paid by a consumer to a supplier in exchange for a prepaid certificate, card, credit, voucher or similar device, is the property of the bearer of that certificate, card, credit, voucher or similar device to the extent that the supplier has not redeemed it in exchange for goods or services, or future access to services. Section 65(2) of the CPA determines that:

- (2) When a supplier has possession of any prepayment, deposit, membership fee, or other money, or any other property belonging to or ordinarily under the control of a consumer, the supplier—
 - (a) must not treat that property as being the property of the supplier;
 - (b) in the handling, safeguarding and utilisation of that property, must exercise the degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person; and
 - (c) is liable to the owner of the property for any loss resulting from a failure to comply with paragraph (a) or (b).

The taxpayer cannot therefore be said to have received the amount for his/her own benefit or own behalf until the earlier of date of redemption or the date of expiry of the voucher of three years. The court found that, before the commencement of the CPA, the taxpayer was correct to indeed have included the full amount received from the issue of gift cards in gross income in the year of issue. However, with the introduction of the CPA, the amount should only be included on the earlier of the date of redemption or expiry of the gift card. This court case therefore also supports the argument in this

¹⁰¹ This principle was laid down in the case of *Geldenhuis v Commissioner for Inland Revenue 1947 (3) SA 256 (C)*.

study that the provisions cannot be looked at in isolation and that other rules and regulations (which might influence it) should also be taken into consideration.

The tax treatment of crowdfunding transactions in the donation and rewards models are discussed below. No specific tax legislation provisions dealing with these models of crowdfunding could be found. The tax treatment of crowdfunding transactions is therefore determined by applying normal tax rules which depend on the crowdfunding model used.

6.3.1.2 Donations received

Gross income (section 1 of the ITA)

Unless an entity or person is specifically exempt from tax, a South African resident is taxed on world-wide income (regardless of the source of income) and a non-resident is taxed only on income of which the source of the amount is South Africa. In terms of section 1 of the ITA, an amount is gross income (and therefore taxable) if it complies with all of the following requirements: “the total amount, in cash or otherwise, received by or accrued to a resident during a year of assessment provided that the amount is not of a capital nature” (South Africa, 1962). All funding received by the creator of a crowdfunding project will therefore be taxable unless the entity is exempt from tax (such as a registered public benefit organisation) or if the income is of a capital nature.

Section 10(1)(cN) of the ITA exempts the receipts and accruals of any public benefit organisation (PBO) from normal income tax. The mere fact that an organisation has a non-profit motive or is established or registered as a non-profit organisation (NPO) under the Non-profit Organisation Act No 71 of 1997 (NPO Act), or is established as a non-profit company (NPC) in terms of the Companies Act No. 71 of 2008 does not mean that it automatically qualifies for preferential tax treatment or approval as a PBO. There is also no requirement that an entity must be a registered NPO in order to register as a PBO for tax purposes.

Section 30(1) of the ITA determines that a public benefit organisation is any organisation which is a non-profit company as defined in section 1 of the Companies Act¹⁰² or a trust or an association of persons that has been incorporated, formed or established in the Republic; or any branch within the Republic of any company, association or trust incorporated, formed or established in any country other than the Republic that is exempt from tax on income in that other country. Section 30(1)(b) of the definition furthermore states that the sole or principal object of the PBO should be to carry on one or more public benefit activities.

Part I of the Ninth Schedule of the ITA contains a list of what is considered to be a public benefit activity. The Minister also has the authority to publish additional public benefit activities by notice in the Government Gazette which should be of a benevolent nature, having regard to the needs, interests and well-being of the general public. The public benefit activity must be carried on in a non-profit manner and with an altruistic or philanthropic intent and no such activity is intended to directly or indirectly promote the economic self-interest of any fiduciary or employee of the organisation, otherwise than by way of reasonable remuneration payable to that fiduciary or employee. The activity should also be carried on by that organisation for the benefit of, or should be widely accessible to, the general public at large, including any sector thereof (other than small and exclusive groups). Entrepreneurs who wish to establish a business with a profitable intent will therefore not be able to make use of this public benefit organisation exemption and will be fully subject to income tax.

If the entity is not exempt from tax, the amount received might still not be taxed if it is of a capital nature. The ITA does not define the term “not of a capital nature”, but the courts have laid down principles that should be considered to determine if a receipt is of a capital nature. In the case of *Lunnon (1924, A.D. 94; 1 SATC 7)*, which was decided

¹⁰² “non-profit company” means a company (a) incorporated for a public benefit or other object as required by item 1 (1) of Schedule 1; and (b) the income and property of which are not distributable to its incorporators, members, directors, officers or persons related to any of them except to the extent permitted by item 1 (3) of Schedule 1.

before the insertion of paragraph (c) of the gross income definition in the ITA, a gratuity was paid to a previous director in recognition of his valuable services on the Board in previous years when the directors' fees were not commensurate with the work involved. The court stated that:

Now this gift had none of the attributes of income; it was not produced by the respondent's capital, nor was it earned by his labour or his wits or in any other way. There was no recurrence about it. What was sometimes called annuality was not necessarily a decisive test as to whether a receipt or accrual was capital or income; but it was an important element to be taken into consideration. And in the present instance it was wholly absent. This grant was a fortuitous addition to the capital of the recipient, and it appeared to His Lordship to be of a capital nature, like any ordinary donation or legacy. (*Lunnon, 1924, A.D. 94; 1 SATC 7*)

Paragraph (c) was subsequently added to the ITA to ensure that, if there is a casual relationship between the amount received and services rendered, the amount is gross income. With reference to paragraph (c) of the gross income definition in section 1, if the ITA (which specifically includes in gross income amounts received for services rendered), the court stated in *ITC 599*¹⁰³ that:

It may perhaps be relevant to detail how that section came to be passed. In the ordinary case where there is an accrual or gift for which no liability rests on the donor to pay, it may be fairly assumed to be an accrual of a capital nature although I do not know of any express decision that crisply decides that point.

The court therefore acknowledged that there is no specific case or provision stating that a donation is of a capital nature. However, it is submitted that it can also be argued that, if an amount is a donation as defined for donations tax purposes, the donor (funder) will be liable for donations tax on the amount donated and the creator will

¹⁰³ *ITC 599 (1945) 14 SATC 272(U)*.

therefore not be taxed on the same amount received. Hence it will be of a capital nature.

A donation is defined in section 55(1) of the ITA as “any gratuitous disposal of property, including any gratuitous waiver or renunciation of a right” (South Africa, 1962). The court found in *ITC 1545*¹⁰⁴ that a payment or disposal of property that is motivated by self-interest or some reason other than liberality and generosity is not “gratuitous” and is therefore not a donation as defined in section 55(1). If the funder therefore makes a donation without any obligation and out of pure generosity, the amount received by the creator will not be gross income since it is fortuitous.

With the rewards model, the amount received from the funders via the platform will form part of the gross income of the project creator. This is because the amount is received/accrued in respect of the sale of trading stock or the provision of a service and is therefore not of a capital nature. The project creator will have to include the amount in gross income on the earlier of the year of assessment during which the amount was received by or accrued to it.

If the project creator is carrying on trade, the acquisition cost of the reward (trading stock provided or cost relating to the service rendered) will qualify for a deduction under section 11(a). If the reward is trading stock, the provisions of section 22 (dealing with trading stock) will also apply. Other expenditure incurred by the project creator relating to its trade might also qualify as a deduction if it complies with the requirements of section 11(a). Assets used by the project creator in the carrying on of its trade might qualify for capital allowances, depending on the type of asset.

If the expenses were incurred prior to the commencement of a trade, section 11A dealing with pre-trade expenditure will have to be considered. The expenses will then only be deductible in the year in which trading commenced. The ITA also permits an allowance in respect of future expenditure to be incurred by the project creator in respect of certain contracts in section 24C.

¹⁰⁴ *ITC 1545 54 SATC 464(C)*.

Tax deductible expenditure (section 11(a))

The project creator will be able to claim trade-related expenses as a deduction if the provisions of section 11(a) of the ITA are complied with. Section 11(a) of the ITA allows a deduction against taxable income for “expenditure and losses actually incurred in the carrying on of a trade and incurred in the production of income provided the expenditure or loss is not of a capital nature” (South Africa, 1962). All the components of section 11(a) need to be met before expenses can be claimed. Since crowdfunding is mainly concerned with the acquisition of funding in order to start a business, the main issues will be to determine at what stage the creator is “carrying on a trade” (if any) and whether or not expenditure incurred was “in the production of income” and is “not of a capital nature”.

Carrying on a trade

The word “trade” is defined in section 1 of the ITA. The definition:

includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature.

In scrutinising other definitions in the ITA, it was found that a number of definitions contain the word “means” in contrast with “includes”. Definitions starting with “means” are exhaustive, clear and certain and provide specific rules such as what is a taxpayer, what is a tax, etc. It was held in *Jones and Company Ltd v CIR*¹⁰⁵ that “includes” as a general rule is not a term of exhaustive definition (although sometimes so employed) but, as a general rule, it is a term of extension. It was also held that, where the Legislature wishes to give a term an exhaustive definition, the word “means” is used, as

¹⁰⁵ *Jones and Company Ltd v CIR*, 1925, 2 SATC 7.

opposed to “includes”. Reference in the definition to “includes” does not always provide certainty of what a trade is, and hence there is not always clarity as to what a trade is and what it is not.

The onus is on the taxpayer to prove that a trade has been conducted in terms of section 102 of Tax Administration Act No. 28 of 2011 (South Africa, 2011). Numerous court cases on the subject of trade are evidence that no explicit and concrete rules exist to establish if a taxpayer is carrying on a trade. Certain guidelines used in determining whether or not a trade is carried on have, however, been laid down by the courts over the years. It is also interesting to note from the case law discussed below, that the words *trade* and *business* are used interchangeably.

The definition of trade is intended to embrace every profitable activity, so it should be given the widest possible interpretation¹⁰⁶. However, this does not imply that “trade” is all embracing¹⁰⁷. The definition of trade includes a business or venture, but neither business nor venture is defined in the ITA. It was held in *ITC 368*¹⁰⁸ that a venture is “a transaction in which a person risks something with the object of making profit”. This was confirmed in the case of *Burgess v CIR*¹⁰⁹, where it was held that the definition of venture does not imply that a scheme is only a trade if it is risky. It is still a trade even if there is no risk involved.

What constitutes a business was found in a UK case, *Smith v Anderson*¹¹⁰ that, “anything which occupies the time and attention and labour of a man for the purpose of profit is business”. South African courts accepted this interpretation as it was held in *Platt v CIR*¹¹¹, that “the acquisition of gain or profit was a material factor in deciding whether the transactions of an individual constituted the carrying on of business.” It was

¹⁰⁶ This was originally held in *ITC 770 (1953) 19 SATC 216(T)* and confirmed in various other case law such as *Burgess v CIR, 1993, 55 SATC 185(A)*.

¹⁰⁷ *ITC 1476 (1989) 52 SATC 141(T)*.

¹⁰⁸ *ITC 368 (1936) 9 SATC 211(U)*.

¹⁰⁹ *Burgess v CIR, 1993, 55 SATC 185(A)*.

¹¹⁰ *Smith V Anderson, 1880 15 Ch.D.247*.

¹¹¹ *Platt v CIR, 1922 AD 42, 32 SATC 142*.

held in *Stephan v CIR* that this definition supplied the criterion that it needs to be determined “whether the transaction was undertaken with the direct and primary object of making a profit and not with a mere hope of making an ultimate profit incidentally in carrying out another purpose¹¹².” From the decided case law it is clear that the acquisition of gain or profit is a material factor in deciding whether or not a trade is being carried on.

It was furthermore held in *Smith v Anderson* that, “if any one formed a company or association for the purpose of acquiring gain, he must form it for the purpose of carrying on a business by which gain is to be obtained.”¹¹³ The judge accepted this in *Platt* and said that “in the case of a company formed for certain purposes, the question of the continuity of the acts, which is another factor to be considered in deciding whether a business is carried on, is not of the same importance as in the case of an individual.”

It was found in *SA Bazaars v CIR* that it is not the carrying on of a trade if activities are merely performed for the purpose of keeping a company in existence. If a company has therefore been formed for a specific purpose and activities associate with the objects for which the company was formed, the company is carrying on a trade¹¹⁴. It was held in *ITC 1275*¹¹⁵ that the mere watching over investments does not constitute the carrying on of a trade. The judge said in *ITC 1476*¹¹⁶ that “carrying on a trade involves an active step – something far more than merely watching over existing investments”.

In *ITC 777*¹¹⁷ it was held that “the extent of the effort or the amount of money expended cannot, however, be the test whether a company or person was trying to get business. It is sufficient if there was some attempt, even if no money was expended.” In the decided case the company was still carrying on a trade even though the property was

¹¹² This was also referred to in *Stephan v CIR, 1919, 32 SATC 54*.

¹¹³ *Smith V Anderson, 1880 15 Ch.D.247*.

¹¹⁴ *SA Bazaars (Pty) Ltd v CIR, 1952, 18 SATC 240*.

¹¹⁵ *ITC 1275 (1978) 40 SATC 197(C)*.

¹¹⁶ *ITC 1476 (1989) 52 SATC 141(T)*.

¹¹⁷ *ITC 777 (1953) 19 SATC 320(T)*.

not actually let due to the fact a lessee could not be found. The company did carry on a trade since it did put in effort to let the property, even though without success. It was held in *ITC 957*¹¹⁸ that factors that need to be considered in order to determine if a business of a money-lender is carried on, are the degree of continuity and systems about the transactions, the frequency of the turnover, and the rate of interest on the loans. In order for a trade to be carried on there must therefore be a certain degree of continuity and system about the transactions¹¹⁹. This is also evident from the opening words of section 11(a) of the ITA which refer to the “carrying on” of a trade. The word “carrying” is indicative of a continuous nature. The mere laying of plans does not constitute the carrying on of a trade in the absence of some positive act aimed at promoting the plans¹²⁰.

However, it was found in *Stephan v CIR*¹²¹ that isolated ventures or transactions performed outside the normal scope of a taxpayer’s ordinary business, but involving the employment of staff and the use of capital of the business, constituted business transactions in the carrying on of a trade. It was held that the “carrying on business” does not imply a series of transactions.

The judge submitted in *CIR v Contour Engineering (Pty) Ltd* that having no premises, equipment, stock, staff, save for book debts, or assets is clearly indicative of a company that is not trading. The absence of staff and assets are, however, not always indicative of no trade and this depends on the nature of the business. It was held in *CIR v Tiger Oats Ltd*¹²² that the company was undertaking a business as an investment holding company even though the company did not have employees and fixed assets. This was because the company was a public listed company that proclaimed the main object to be the carrying on of the business of an investment holding company, paying management fees in respect of management services provided to the subsidiaries. The

¹¹⁸ *ITC 957 (1960) 24 SATC 637(O)*.

¹¹⁹ *Sentra-Oes Koöperatief Bpk v KvB, 1994 and 1995, 57 SATC 109*.

¹²⁰ *CIR v Contour Engineering (Pty) Ltd, 1999, 61 SATC 447*.

¹²¹ *Stephan v CIR, 1919, 32 SATC 54*.

¹²² *CIR v Tiger Oats Ltd, 2003, 65 SATC 281*.

court held that the fact that it was formed for such purpose of investment holding, indicates *prima facie* the presence of the element of continuity of activity. This is in accordance with what was decided in *Smith v Anderson* and *Plat v CIR* (as discussed above and referred to by the court in the *Tiger Oats* case) although the *Tiger Oats* case did not deal with the meaning of the ITA but with the meaning of business in the Regional Service Council Act No. 109 of 1985.

In *ITC 1802*¹²³, the activities of the company were compared to those in the *Tiger Oats* case. It was consequently held that the holding company in *ITC 1802* was not carrying on a trade since it was merely “keeping itself alive” by performing activities to comply with the statutory requirements for “life” as a legal entity. In comparison with the *Tiger Oats* case, there was no evidence of a controlling mind over the subsidiaries, involvement in the affairs of the subsidiaries or of strategic management in the case of *ITC 1802*. The judge affirmed in *ITC 1802* that “trade” has a variety of meanings and “is capable of embracing a great diversity of circumstances and activities”. He also contended that most useful would be to ask “What did the taxpayer actually do?” and to closely examine the nature of the activities carried on by the taxpayer in order to arrive at the answer.

Guidelines laid down in previous cases to determine whether a person was carrying on the business of a money-lender or banker, were confirmed in the case of *Solaglass Finance Company (Pty) Ltd v CIR*¹²⁴. It is submitted that these guidelines can be applied to any type of business, and comprise an investigation into the intention of the person, whether or not a system or plan which discloses a degree of continuity is in place, whether or not a specific type of transaction/activity is a feature of the specific type of business, and whether or not there is a certain degree of continuity and system about the transactions and the proportion of the income from the specific business to the total income (however, the size of the proportions cannot be decisive if the other elements are in existence).

¹²³ *ITC 1802 (2005) 68 SATC 67.*

¹²⁴ *Solaglass Finance Company (Pty) Ltd v CIR, 53 SATC 1.*

Section 23(g) of the ITA requires that only moneys laid out or expended for purposes of trade is deductible. The judge held in the *Solaglass* case, referred to above, that the expression “any moneys” is no different from the “expenditure and losses” referred to in section 11(a). When moneys are laid out and expended, expenditure or losses are incurred. The judge referred to UK case law in order to determine if moneys were exclusively laid out or expended for purposes of trade¹²⁵. At the time of the judgement section 23(g) determined that moneys which are not wholly or exclusively laid out or expended for purposes of trade, is not deductible. If expenditure was therefore incurred with a dual purpose (i.e., a trade purpose as well as a private purpose), section 23(g) prohibited the deduction since it was not exclusively incurred for trade purposes¹²⁶. This section was, however, amended in 1992 and now determines that a deduction can be claimed to *the extent* to which such moneys were laid out or expended for purposes of trade. This implies that the expenditure can be apportioned to only allow as a deduction the part that was laid out or expended for trade purposes. It was found that, in order to determine the purpose of the expense, it is necessary to examine the nature of the activities carried on, the nature of the expenditure and the closeness (or remoteness) of the connection between the expenditure and the benefit derived therefrom¹²⁷.

The principles or guidelines laid down by our courts to determine whether a trade or business is carried on, are similar to those of the USA. It was concluded in a study conducted by Messamer (1954:114) on what constitutes trade or business within the Federal Income Tax laws, that the following need to be present: (1) sufficient time and attention should be devoted, (2) a trade or business must be entered into with a profit motive or an expectation of profit, (3) the intent of the parties is an important factor and

¹²⁵ *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co (a firm) (1990)*, 1 All ER 45; *Mallalieu v Drummond (Inspector of Taxes) (1983)*, 2 All ER 1095.

¹²⁶ *Solaglass Finance Company (Pty) Ltd v CIR*, 53 SATC 1; *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co (a firm) (1990)*, 1 All ER 45; *Mallalieu v Drummond (Inspector of Taxes) (1983)*, 2 All ER 1095.

¹²⁷ *Solaglass Finance Company (Pty) Ltd v CIR*, 1990, 53 SATC 1.

(4) it involves more than the mere management of investments and the collection of rents, interest and dividends.

According to Olson (1985:1235) (a USA-decided case), the main purpose of “trade or business” is to distinguish business activities from a taxpayer’s investment, and personal activities. Olson (1985:1234) suggests that, in order to distinguish business activities from personal activities, the intention of the activity must be to make a profit. Furthermore, in order to separate businesses from other income-producing activities, the taxpayer that engages in the activity must present himself as providing goods and services to someone other than himself. This second requirement is often referred to as the “goods and services test” and was held in the case of *Deputy v Du Pont*¹²⁸. These principles are similarly applicable in a SA context.

In the production of income

Expenditure incurred in the carrying on a trade is only deductible if it is incurred for the purpose of earning income. The judge pointed out in the *PE Electric Tramway*¹²⁹ case that in a literal sense expenditure and losses do not produce income and that income “results from work and labour or the use of capital in productive enterprise or the loan of capital and it is produced in diverse ways”. It was furthermore held in that case that income is produced from a series of acts and that it needs to be determined if the act to which the expenditure is attached, is performed in the production of income and if the expenditure is closely enough linked to that act. If the expense is closely connected with the business operations, it is deductible even if no income has actually resulted or if the income will only be generated in subsequent years¹³⁰.

It was held in *ITC 697*¹³¹ that expenditure incurred prior to a business being so equipped as to be capable of being employed for profit-earning purposes, is not laid out

¹²⁸ *Deputy v Du Pont*, 1940, 308 U.S. 488, 499.

¹²⁹ *Port Elizabeth Electric Tramway Company Ltd v CIR*, 1936, 8 SATC 13.

¹³⁰ *Sub-Nigel v CIR*, 1948, 15 SATC 381.

¹³¹ *ITC 697 (1950) 17 SATC 93(T)*.

in the production of income and not deductible. The underlying asset must therefore be in an income-producing stage before it can be said that the expenditure has been incurred in the production of income¹³². If an existing business is expanded by creating an asset for use in that business, expenditure incurred on that newly-created asset before bringing that asset into use in the existing business, is not incurred in the carrying on of the existing trade¹³³. It follows that the underlying asset must therefore be in an income-producing stage (capable of producing income) and must be used in the business for producing income before expenditure can be said to be incurred in the production of income.

Not of a capital nature

The judge held in *New State Areas Ltd v CIR*¹³⁴ with reference to the *PE Tramway* case that:

save in the case of the leasing or the loan of capital in some form or other, income is produced by work or service or activities or operations and as a rule expenditure is attendant upon the performance of such operations sometimes necessarily, sometimes not. Expenditure may also occur in the acquisition by the taxpayer of the means of production, i.e., the property plant, tools, etc., which he uses in the performance of his income-earning operations and not only for their acquisition but for their expansion and improvement. Both these forms of expenditure can be described as expenditure in the production of the income but the former is, as a rule, current or revenue expenditure, and the latter is, as a rule, expenditure of a capital nature. As to the latter the distinction must be remembered between floating or circulating and fixed capital.

¹³² *ITC 318 (1935) 8 SATC 174(U); ITC 697 (1950) 17 SATC 93(T); Borstlap v SVB, 1981, 43 SATC 195; ITC 1593 (1994) 57 SATC 251.*

¹³³ *Reef Estates Ltd v CIR, 1954, 19 SATC 153.*

¹³⁴ *New State Areas Ltd v CIR, 1946, 14 SATC 155.*

It was held that expenditure of a fixed capital nature is not deductible but that expenditure of a floating capital nature is deductible. The true nature of a transaction must be determined. A distinction should therefore be made between the expenditure incurred as part of the cost of performing the income-earning operations and expenditure incurred as part of the cost of establishing, improving or adding to the income-earning asset.

6.3.1.3 Donations made by the donor

The amount of the donation made by the funder is generally not tax deductible since it is a payment of a capital nature. However, some exceptions do apply which are discussed below.

Tax deductible expense (section 11(a))

The general deduction formula in section 11(a) of the ITA was discussed under section 6.3.1.2 and allows a deduction against taxable income for expenditure and losses actually incurred in the carrying on of a trade and incurred in the production of income, provided the expenditure or loss is not of a capital nature.

If the funder can therefore prove that the donation is used to advertise the funder's trade and that the payment is not of a capital nature, the amount of the donation will be tax deductible as a marketing expense.

It can be argued with the rewards model where the funder receives a product/service in turn for the contribution made, that the funder made a pre-payment in return for the promised reward. The investment made by the funder might then be deductible if it can be argued that the product/service purchased was for trade purposes.

If it is argued that the amount funded was gratuitous, the amount funded will not be deductible. The reward received in return might furthermore form part of the gross income of the funder. An amount is gross income if it was actually received by or

accrued to a person. The amount need not be money but can be anything that has a money value or that can be turned into money. If it can be argued that the reward is of a capital nature, it will not be part of gross income.

In order to attain Broad-Based Black Economic Empowerment (B-BBEE) scoring, enterprises are encouraged to spend 1% of their net profit after tax annually to Enterprise Development Contributions. An entity must furthermore achieve a 40% subminimum of the Enterprise Development target to avoid discounting of the B-BBEE level. This is in terms of the Codes of Good Practice issued under section 9(1) of the Broad-Based Black Economic Empowerment Act No. 53 of 2003 by way of Notice 1019, Government Gazette of 11 October 2013. It is also permitted for a measured entity to make payments to qualified third parties to perform Enterprise Development on their behalf and still being recognised for purposes of the B-BBEE score¹³⁵. Payments made to SBFES or incubator/ propeller entities will therefore be recognised for purposes of the B-BBEE scorecard. However, as was explained in section 6.2.1, the ITA does not allow a deduction for donations made to a SBFE. The entity will therefore have to prove that enterprise development contributions are deductible in terms of section 11(a) read with section 23(g).

In a judgement of the Supreme Court of Appeal of *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty)*¹³⁶, it was found that a donation made to the Urban Foundation for advertising purposes was not tax deductible. The Urban Foundation was concerned with the upgrading of housing and the provision of community facilities in order to address SA's social needs¹³⁷. Pick 'n Pay argued that the donation was made for advertising purposes and thereby incurred for trade purposes. However, it was found that the contribution was not tax deductible since "Pick 'n Pay did not show,

¹³⁵ Section 9.1.23 of Statement 400 of the Broad-Based Black Economic Empowerment Act No. 53 of 2003.

¹³⁶ *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd (44/87) [1987] ZASCA 44; [1987] 4 All SA 432 (AD) (14 May 1987)*.

¹³⁷ *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd (44/87) [1987] ZASCA 44; [1987] 4 All SA 432 (AD) (14 May 1987) page 434*.

on the probabilities, that in making the donation it did not have a philanthropic purpose as well as a business purpose”¹³⁸.

As was mentioned under section 6.3.1.2, section 23(g) has subsequently been amended to allow a deduction to the extent that a dual expense has been incurred for purposes of trade. It was held in *CIR v Nemojim Pty (Ltd)* (45 SATC 241) that expenditure incurred for a dual purpose should be apportioned. A deduction will therefore now be allowed to the extent that the expenditure has been incurred for advertising purposes.

An appeal was upheld in the case of *Warner Lambert SA (Pty) Ltd v Commissioner for SARS*¹³⁹ that dealt with the deduction of social responsibility expenditure. It was held that the social responsibility expenses incurred, reduced the risk that the appellant might lose its subsidiary status which might result in the loss of all kinds of trade advantages. The expenses were therefore incurred in the production of income for purposes of trade. It was furthermore held that the expenses were not of a capital nature and were seen as similar to insurance premiums. It was incurred to protect the company’s earnings and was revenue in nature.

The DTC suggested that the ITA be amended to allow a deduction for all expenditure associated with the sponsorship and enhancement of small businesses (Davis Tax Committee, 2016b:35).

Tax deductible donation (section 18A)

If the donation is not deductible in terms of section 11(a) as a trade-related expense, the donation may be deductible in terms of section 18A of the ITA if the creator is recognised as a registered public benefit organisation (PBO) (refer to section 6.3.1).

¹³⁸ *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* (44/87) [1987] ZASCA 44; [1987] 4 All SA 432 (AD) (14 May 1987) page 442.

¹³⁹ *Warner Lambert SA (Pty) Ltd v Commissioner for SARS* 2003 JOL 11098 (SCA).

The deduction is limited to 10% of the taxable income of the funder. Any excess above the 10%-limit, can be carried forward to the next year of assessment.

In order to register as a PBO, the entity must carry on a public benefit activity. Public benefit activities are listed in Part I of the Ninth Schedule and are of benevolent nature, having regard to the needs, interest and well-being of the general public. Not all crowdfunding projects will therefore be able to register as PBOs. The deduction is furthermore only claimable by the funder of a PBO, if the activity is listed in Part II of the Ninth Schedule. It is therefore possible that the entity is a PBO, but that the activity carried on by the PBO for which a contribution is made, does not fall within Part II of the Ninth Schedule, thereby disallowing the section 18A deduction to the funder.

Due to the benevolent nature of the activities that qualify for a section 18A deduction, mainly charitable causes will qualify for this deduction. Paragraph (p) of the Part II of the Ninth Schedule includes “community development for poor and needy persons and anti-poverty initiatives such as the provision of training, support or assistance to emerging micro enterprises to improve capacity to start and manage business, which may include the granting of loans on such conditions as may be prescribed by the Minister by way of regulation”. However, similar to section 37G (see section 6.2.2.), no such regulations could be found. This tax deduction can therefore not be regarded as an incentive to funders of small businesses.

Donations tax

If the contribution made by the funder is a donation of a capital nature, the funder may furthermore be liable for the payment of donations tax. Donations tax is levied in Part V of the ITA sections 54 to 64 at a rate of 20% of the value of the property that was disposed of under a donation by a resident of the Republic of South Africa, provided the said donation is R30 million or less.

A donation is defined in section 54 as any gratuitous disposal of property, including any gratuitous waiver or renunciation of a right. Property in return is defined as any right in

or to property movable or immovable, corporeal or incorporeal, wherever situated. The donation is deemed to take effect upon the date upon which all the legal formalities for a valid donation have been complied with (section 54(3)).

Section 54 of the ITA contains a list of donations which are exempt from donations tax. The exemptions that might apply (in exceptional circumstances) to crowdfunding transactions are:

- section 56(1)(b) – donations made to the spouse of the funder or for the benefit of the spouse of the funder;
- section 56(1)(e) – donations cancelled within six months from the date upon which they took effect;
- section 56(1)(f) - donation made by or to or for the benefit of any traditional council, traditional community or any tribe referred to in section 10(1)(t)(vii);
- section 56(1)(h) – donations by or to an SBFE or a PBO;
- section 56(1)(k) – donation made as a voluntary award where the value of the donation is required to be included in the gross income of the donor in terms of paragraphs (c) (services rendered), (d) (lump sums from employers) or (i) (fringe benefits) of the definition of gross income; and
- section 56(1)(n) – a donation made by any company which is recognised as a public company in terms of section 38 (any company which has been approved as a public benefit organisation in terms of the provisions of section 30(3) is recognised as a public company).

There is not a specific exemption for donations made to a crowdfunding project. The crowdfunding project will have to meet one of the criteria listed in section 56. Most donations will therefore be subject to donations tax. However, the annual exemption of R100 000 for a natural person (R10 000 for a funder other than a natural person) will apply and will exempt donations made to crowdfunding projects, to the extent that the R100 000 was not yet utilised (section 56(2)).

It is submitted that an exemption or tax deduction should be considered in the ITA for donations made by funders to entrepreneurial crowdfunding projects. This will be considered later in this thesis.

6.3.2 Debt model

In terms of the lending model, the funder is advancing money to the creator (borrower) at a predetermined interest rate. This model is also referred to as the debt-model or as peer-to-peer lending.

6.3.2.1 Regulatory requirements

Certain crowdfunding transactions are subject to existing legislation and regulation. This depends on the nature of the transaction and crowdfunding model. See section 6.3.3.1 for a discussion of some of the existing regulations that might apply to the lending model.

The term “securities” is defined in section 1 of the Companies Act and means any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company. According to De Beer (2014:47-48), it is not clear what is meant by “other instrument” in this definition and it is possible that debt-based crowdfunding could fall under securities.

A “share” is defined in section 1 of the Companies Act and means one of the units into which the proprietary interest in a profit company is divided. This definition is similar to the definition of a share in the ITA which states that “share” means, in relation to any company, any unit into which the proprietary interest in that company is divided. The Companies Act does not, however, contain a definition of “debenture”. According to De Beer (2014:48), there is no substantive test in South African law for or delineation of what a debenture or other debt instrument, as referred to in the definition of “securities”, is. If debt-based crowdfunding therefore falls within the ambit of debenture or other

instrument, it is a security and the Companies Act will apply. The definition of “securities” differs in various acts of which some are indicated in Table 12.

Table 12: Comparison of the definition of securities (Own construct)

Income Tax Act	Companies Act	Financial Markets Act	Securities Transfer Act
	Any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company.	<p>(a) listed and unlisted—</p> <p>(i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980);</p> <p>(ii) debentures, and bonds issued by public companies, public state-owned enterprises, the South African Reserve Bank and the Government of the Republic of South Africa;</p> <p>(iii) derivative instruments;</p> <p>(iv) notes;</p> <p>(v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Authority in terms of section 65 of that Act;</p> <p>(vi) instruments based on an index;</p> <p>(b) units or any other form</p>	<p>(a) any share or depository receipt in a company; or</p> <p>(b) any member's interest in a close corporation, excluding the debt portion in respect of a share linked to a debenture.</p>

Income Tax Act	Companies Act	Financial Markets Act	Securities Transfer Act
		<p>of participation in a collective investment scheme licensed or registered in a country other than the Republic;</p> <p>(c) the securities contemplated in paragraphs (a) (i) to (vi) and (b) that are listed on an external exchange;</p> <p>(d) an instrument similar to one or more of the securities contemplated in paragraphs (a) to (c) prescribed by the registrar to be a security for the purposes of this Act;</p> <p>(e) rights in the securities referred to in paragraphs (a) to (d), but excludes—</p> <p>(i) money market securities, except for the purposes of Chapter IV; or if prescribed by the registrar as contemplated in paragraph (d);</p> <p>(ii) the share capital of the South African Reserve Bank referred to in section 21 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989); and</p> <p>(iii) any security contemplated in paragraph (a) prescribed by the registrar;</p>	

From the table above, it is evident that the definition of securities, in the Companies Act, Financial Markets Act and the Securities Transfer Act, includes a “share”. The ITA does not contain a definition of securities. The various definitions in the different legislation, complicates the interpretation of the legislation. However, as is evident from Table 13 below, the definition of a share differs in the various acts.

Table 13: Comparison of the definition of a share (Own construct)

Income Tax Act	Companies Act	Financial Markets Act	Securities Transfer Act
In relation to a company, any unit into which the proprietary interest in that company is divided.	One of the units into which the proprietary interest in a profit company is divided.		Share is not defined, however, “listed share” means any share or depository receipt in a company that is listed on an exchange.

Different definitions in various South African legislations of securities, shares etc. aid in the difficulty of complying with and interpreting the legislation. It is not always clear whether or not debt-based crowdfunding falls within the various acts. Various terms are not always defined in the acts.

6.3.2.2 Tax implications

Funding received

If the project creator makes money available to the project owner in the form of a loan agreement, the project creator will not be taxed on the loan amount received since it is of a capital nature. This is because the funder has a right to repayment as soon as the funding is made available.

The project creator will be able to deduct the interest incurred as an expense in terms of section 24J(2) of the ITA. The interest is deductible if it was incurred in the production of income in the carrying on of a trade, even if it is capital in nature¹⁴⁰. In a court case

¹⁴⁰ Section 24J(2) of the Income Tax Act.

decided in 1955, borrowing occurred which was similar to crowdfunding. In *CIR v Genn*¹⁴¹, the company obtained loans from various funders, arranged by an intermediary company, at a total cost of 10% per annum. The 10% cost included the interest payable on the loans to the funders as well as commission or a raising fee payable to the intermediary company. It was held that interest paid on a loan amount (whether the loan was for the acquisition of fixed or floating capital) is incurred in the production of income if it was used for the purposes of a business.

Section 24J determines that interest incurred or paid in respect of an instrument should be deducted from the taxable income by using the yield to maturity rate and thereby effectively spreading the interest over the period of the agreement. An instrument as defined in section 24J(1) includes an interest-bearing arrangement and debt. An interest-bearing arrangement and debt are, however, not further defined and should therefore be given its ordinary meaning. Interest is defined in section 24J to include the gross amount of interest or similar finance charges, discount or premium payable or receivable in terms of a financial arrangement. A financial arrangement is not defined in the ITA but a financial instrument is defined section 1 of the ITA. The definition of financial instrument includes *inter alia* a loan, advance, debt, any interest-bearing arrangement, any financial arrangement (based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset) and any cryptocurrency.

If the debt owed to the funder is subsequently waived or written off by the funder, the provisions of section 19 and paragraph 12A of the Eighth Schedule might apply.

Funding provided

The loan granted will not be deductible since it is capital in nature. The interest received by the funder will be taxed since it is an amount received by or accrued to in terms of the gross income definition. However, section 24J(3) might apply if the funder is a company that holds an instrument or a natural person who holds an income

¹⁴¹ *Commissioner for Inland Revenue v Genn (Pty) Ltd 20 SATC 113 (1955)*.

instrument (as defined). If section 24J(3) applies, the interest will be included by using the yield to maturity rate and thereby effectively spreading the deduction of interest over the period of the agreement. An income instrument is an instrument (as defined) of which the term will, or is reasonably likely to, exceed one year and which is issued or acquired at a discount or premium or bears deferred interest¹⁴².

If it is South African source interest, the funder will qualify for the section 10(1)(i) interest exemption. The exemption is, however, a limited exemption depending on the age of the taxpayer and is only available to natural persons.

Care should be taken of section 8FA of the ITA which deems the interest on certain interest-bearing arrangements or debt owed by a company to be hybrid interest. The interest is deemed to be hybrid interest where the interest is not determined with reference to a specified rate of interest or the time value of money¹⁴³. The difference between interest charged at an increased rate by reason of an increase in the profits of a company and the lowest rate of interest in the current and past five years, is also deemed to be hybrid interest¹⁴⁴. Section 8FA(2) determines that hybrid interest is deemed to be a dividend in specie and is not deductible. The borrower will therefore have to pay 20% dividends tax on the hybrid interest and will not be able to claim a deduction for the hybrid interest paid to the lender. The lender in turn will receive a dividend which will qualify for the dividend exemption in section 10(1)(k)(i) of the ITA. Section 8FA does, however, not apply to any interest on debt owed by a small business corporation as defined in section 12E(4) of the ITA¹⁴⁵.

If the funder provides a cash investment, specifically structured not to be a loan, different tax consequences might arise. If, furthermore, a profit-sharing agreement is entered into (like a joint operation), the funder will be taxed on the profit. If the profit (or return) falls within the ambit of interest for purposes of section 24J, the interest will be

¹⁴² Section 24J(1) of the Income Tax Act.

¹⁴³ Section 8FA(1)(a) of the Income Tax Act.

¹⁴⁴ Section 8FA(1)(b) of the Income Tax Act.

¹⁴⁵ Section 8FA(3)(a) of the Income Tax Act.

spread over the period of the agreement as discussed above. The reference to “interest or similar finance charges, discount or premium payable or receivable in terms of a financial arrangement” in the definition of interest, might be problematic. A financial arrangement is not defined in the ITA but a financial instrument is defined in section 1 of the ITA. The definition of financial instrument includes *inter alia* a loan, advance, debt, any interest-bearing arrangement, any financial arrangement (based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset) and any cryptocurrency. If a profit-sharing agreement falls within the ambit of a financial arrangement (being that the arrangement is determined with reference to cash flow), it might be said that the profit so earned, is interest (being a similar finance charge or premium).

6.3.3 Equity model

Equity-based crowdfunding refers to a crowdfunding model where the funder receives shares in the project company in return for the funding provided. The rewards are either shares of the venture, dividends and/or voting rights (Hemer, 2011:14). The ITA contains specific provisions dealing with shares and dividends. However, other existing regulations should also be complied with in order to make the transaction a valid transaction in terms of South African law. Some of the other regulatory requirements are referred to below.

6.3.3.1 Regulatory requirements

The main focus of the study is to develop a tax framework for crowdfunding in South Africa. The focus is therefore on the ITA. However, certain crowdfunding transactions are subject to other existing legislation and regulation. This depends on the nature of the transaction and the crowdfunding model. Such legislation is briefly referred to below.

Companies Act No. 71 of 2008

The Companies Act No. 71 of 2008 (Companies Act) provides for the incorporation, registration, organisation and management of companies in South Africa. There are two types of companies that can be incorporated, namely profit companies and non-profit companies¹⁴⁶. A profit company can be a private or a public company. The cost of compliance of a public company is higher than that of a private company since the public company needs to comply with all the disclosure, financial reporting, auditing and general governance requirements of the Companies Act (such as those contained in Chapter 4 of the Companies Act) and other financial legislation.

A private company is prohibited by section 8(2)(b)(ii)(aa) from making offerings of securities to the public. The transferability of securities of a private company is also restricted¹⁴⁷. If a private company therefore issues additional shares, the shares must first be offered to the existing shareholders¹⁴⁸.

The Companies Act does not contain a general definition of "public". Chapter 4 of the Companies Act (which deals with public offerings of company securities) contains a definition of what an "offer to the public" is. According to Delpont (2019:54(12)), the definitions in Chapter 4 only apply to the provisions in Chapter 4. Therefore, "public" in respect of the prohibition of the offering of securities of a private company as contained in section 8(2)(b), must be interpreted in the ordinary meaning of the word.

According to Delpont (2019:54(12)):

the common law meaning of "Public" would be: "No particular number are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the

¹⁴⁶ Section 8 of the Companies Act No. 71 of 2008.

¹⁴⁷ Section 8(2)(b)(ii)(bb) of the Companies Act No. 71 of 2008.

¹⁴⁸ Section 39(2) of the Companies Act No. 71 of 2008.

offer is such as to be open to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. (Nash v Lynde [1929] AC 158 at 169)

Delport (2019:54(13)) also submits that:

[t]he common law meaning of "offer" also does not include an invitation. An invitation to solicit an offer from the invitee is not an offer within the ordinary, common law meaning thereof as in subs (2)(b)(ii)(aa). See, e.g., the definition of "prospectus" in s 229 of the Companies Act No. 46 of 1926 that applied to the whole Act and which included an invitation.

Delport is therefore of the opinion that a private company would be able to offer securities to the public and to issue a prospectus in terms of Chapter 4 of the Companies Act if “the category of addresses falls outside the ordinary common law meaning of "public" but within the meaning as in Chapter 4” (Delport. 2019:54(13)). If therefore, in terms of the ordinary meaning, an offer is not an offer to the public, the company can register as a private company. However, if that private company then makes an “offer to the public” as defined in Chapter 4, then that company will have to comply with the requirements of Chapter 4.

The crowdfunding platforms typically require a prospective funder to register on the platform before actual funding to a project can be made. It is doubted whether this can then be argued to result in the offer not being a public offer in terms of common law because it is limited to only the persons registered and not the general public. Any person can register on the platform and it is therefore submitted that crowdfunding is a public offer. The essence of crowdfunding as defined in this thesis is an “open call” (section 1.2) and not limited to only a specific group of people. If, however, it can be argued that it is not an offer to the public in the ordinary meaning, the private company will still have to issue a prospectus and comply with the requirements in Chapter 4 of the Companies Act if it is a public offer as defined in that chapter.

In terms of Chapter 4 of the Companies Act, an “offer to the public” includes an offer of securities to be issued by a company to any section of the public, whether selected as holders of that company’s securities; as clients of the person issuing the prospectus; as the holders of any particular class of property; or in any other manner. It does not include an offer made in any of the circumstances contemplated in section 96, or a secondary offer effected through an exchange. An “offer” is defined in Chapter 4 as, in relation to securities, an offer made in any way by any person with respect to the acquisition, for consideration, of any securities in a company.

Included in the list of offers that are not public offers, as contained in section 96, are offers of which the total contemplated acquisition cost of the securities, for any single addressee acting as principal, is equal to or greater than R100 000¹⁴⁹. Also if it is an offer, or one of a series of offers, for subscription, made in writing, and– (i) no offer in the series is accompanied by or made by means of an advertisement and no selling expenses are incurred in connection with any offer in the series; (ii) the issue of securities under any one offer in the series is finalised within six months after the date that the offer was first made; (iii) the offer, or series of offers in aggregate, is or are accepted by a maximum of fifty persons acting as principals; (iv) the subscription price, including any premium, of the securities issued in respect of the series of offers, does not exceed, in aggregate, the amount of R100 000; and (v) no similar offer, or offer in a series of offers, has been made by the company within six months immediately before the offer, or first of a series of offers, as the case may be¹⁵⁰. Crowdfunding offers are made by project creators on a platform. This serves as an “advertisement” of the company and an invitation to subscribe to shares. The requirements of the Companies Act are not clear. It is therefore possible that various structures and schemes can be created in order to prevent a company from falling within the ambit of the reporting and filing requirements of the Companies Act.

Laubscher (2016) is of the opinion that a South African equity platform will fall within the ambit of section 95 of the Companies Act and will therefore be required to be registered

¹⁴⁹ Section 96(1)(b) of the Companies Act No. 71 of 2008.

¹⁵⁰ Section 96(1)(g) and section 96(2)(a) and (b) of the Companies Act No. 71 of 2008.

as a public company. The financial statements of a public company must be audited and any other profit or non-profit company's financial statements must be audited if it is required by the regulations made by the Minister¹⁵¹. This requirement to be audited increases the cost of compliance which can be burdensome, especially to a start-up company.

The Companies Act refers to three types of offers, namely an initial public offering, a primary offering and a secondary offering¹⁵². Each of these types of offerings can be in respect of listed or unlisted securities. An initial offer to the public of securities should be accompanied by a registered prospectus¹⁵³. A primary offer to the public of listed securities is only allowed if it complies with the requirements of the relevant exchange¹⁵⁴. However, a primary offer to the public of unlisted securities should be accompanied by a registered prospectus that satisfies the requirements of section 100 of the Companies Act¹⁵⁵. If a prospectus is required, the compliance cost of the company increases.

An offer is not a public offer for the purpose of Chapter 4 of the Companies Act if it is a secondary offer¹⁵⁶. A secondary offer is defined as "an offer for sale to the public of any securities of a company or its subsidiary, made by or on behalf of a person other than that company or subsidiary"¹⁵⁷. Since the shares of a private company must first be offered to the existing shareholders, it seems that it is possible to issue shares to the public if it is a secondary offer where the existing shareholders do not want the shares.

Crowdfunding was defined in Chapter 1 as "...an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or for some form of reward to support initiatives for specific

¹⁵¹ Section 30(2) of the Companies Act No. 71 of 2008.

¹⁵² Section 96(1)(e), (i) and (m) of the Companies Act No. 71 of 2008.

¹⁵³ Section 99(2) of the Companies Act No. 71 of 2008.

¹⁵⁴ Section 99(3)(a)(i) of the Companies Act No. 71 of 2008.

¹⁵⁵ Section 99(3)(a)(ii) of the Companies Act No. 71 of 2008.

¹⁵⁶ Section 96(1)(h)(ii) of the Companies Act No. 71 of 2008.

¹⁵⁷ Section 96(1)(m) of the Companies Act No. 71 of 2008.

purposes". As furthermore stated in that chapter, crowdfunding involves a large number of people making small contributions. A detailed and comprehensive study of the Companies Act requirements is beyond the scope of this study. What is clear, is that the requirements of the Companies Act are not clear when it comes to crowdfunding.

Banks Act No. 31 of 1990

Activities of crowdfunding could be seen as deposit-taking, making them subject to the Banks Act No. 31 of 1990 (South Africa, 1990). Section 11 of the Banks Act provides that a person shall be guilty of an offence if the person conduct the business of a bank and is not a public company, registered as a bank in terms of the Banks Act.

A deposit is defined in section 1 and does not include an amount of money:

- (i) paid as an advance, or as part payment, in terms of a contract for the sale, letting and hiring or other provision of movable or immovable property or of services, and which is repayable only in the event of-
 - (aa) that property or those services not in fact being sold, let and hired or otherwise provided;
 - (bb) the fulfilment of a resolutive condition forming part of that contract; or
 - (cc) the non-fulfilment of a suspensive condition forming part of that contract;
- (ii) paid as security for the performance of a contract or as security in respect of any loss which may result from the non-performance of a contract;
- (iii) without derogating from the provisions of paragraph (ii), paid as security for the delivery up or return of any movable or immovable property, whether in a particular state of repair or otherwise; (South Africa, 1990).

According to Röhler and Wenzlaff (2011:22), most crowdfunding platforms cooperate with a payment provider or a specific bank. There are specific provisions in the ITA applicable to banks. However, crowdfunding platforms typically use escrow accounts to hold the funds received from funders. They therefore prefer to be seen as facilitators of

payments rather than deposit-taking institutions (Pekmezovic & Walker, 2016:389). This relieves them of complying with regulations of the Banks Act.

Collective Investment Scheme Control Act No. 45 of 2002

It was declared in a press release of the Financial Services Board (FSB) on 15 October 2015 that crowdfunding falls outside the regulatory net of the FSB (Financial Services Board, 2015). The Financial Sector Regulation Act was signed into law on 21 August 2017 to establish a system of financial regulation by establishing the Prudential Authority and the FSCA. The Prudential Authority assumed the FSB's responsibilities for non-bank financial institution prudential supervision and the FSB's responsibilities for market conduct were assumed by the FSCA. The purpose of the FSCA is responsible for market conduct regulation and supervision (FSCA, n.d.). The FSCA administers the Collective Investment Scheme Control Act No. 45 of 2002 (South Africa, 2002), the Financial Advisory and Intermediary Services Act No. 37 of 2002 (South Africa, 2002) and the Financial Markets Act No. 19 of 2012 (South Africa, 2012). Where investments are pooled and invested into securities, the Collective Investment Schemes Control Act (South Africa, 2002) should be considered. A collective investment scheme is defined as:

a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which (a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and (b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a collective investment scheme authorised by any other Act¹⁵⁸.

¹⁵⁸ Section 1 of the Collective Investment Scheme Control Act No. 45 of 2002.

A participatory interest is furthermore defined as:

any interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio.¹⁵⁹

According to De Beer (2014:43-44), debt-based and equity crowdfunding will most likely not fall within the ambit of this Act for the following reasons: an interest is acquired in a specific business venture and not in an intermediary entity; facilitators do not bundle offers together and lastly, a manager does not administer the investor's interest in any of their investment since the relationship is between the venture (project creator) and the investor.

There are specific provisions in the ITA applicable to collective investment schemes and amounts received from a collective investment scheme.

Financial Advisory and Intermediary Services Act No. 37 of 2002

If the platform or project creator provides intermediary service or advice regarding a financial product (as defined), the regulations of the Financial Advisory and Intermediary Services Act No. 37 of 2002 (South Africa, 2002) should be complied with. The definition of a financial product in section 1 of the Act includes securities and instruments which in turn includes-

- (a) Securities and instruments which includes
 - (i) shares in a company other than a 'share block company' as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980);
 - (ii) debentures and securitised debt;
 - (iii) any money-market instrument;

¹⁵⁹ Section 1 of the Collective Investment Scheme Control Act No. 45 of 2002.

- (iv) any warrant, certificate, and other instrument acknowledging, conferring or creating rights to subscribe to, acquire, dispose of, or convert securities and instruments referred to in subparagraphs (i), (ii) and (iii);
- (v) any 'securities' as defined in section 1 of the Financial Markets Act, 2012 (Act No. 19 of 2012);
- (b) a participatory interest in one or more collective investment schemes;
- (e) a foreign currency denominated investment instrument, including a foreign currency deposit;
- (f) a deposit as defined in section 1 (1) of the Banks Act, 1990 (Act No. 94 of 1990);
- (h) any other product similar in nature to any financial product referred to in paragraphs (a) to (g), inclusive, declared by the registrar by notice in the Gazette to be a financial product for the purposes of this Act;
- (i) any combined product containing one or more of the financial products referred to in paragraphs (a) to (h), inclusive;
- (j) any financial product issued by any foreign product supplier and which in nature and character is essentially similar or corresponding to a financial product referred to in paragraph (a) to (i), inclusive.

Financial Markets Act No. 19 of 2012

The Financial Markets Act No. 19 of 2012 (South Africa, 2012) was signed into law on 5 February 2013. The object of this Act is to ensure that the South African financial markets are fair, efficient and transparent; to increase confidence in the South African financial markets (by requiring that securities services be provided in a fair, efficient and transparent manner; and by contributing to the maintenance of a stable financial market environment); to promote the protection of regulated persons, clients and investors; to reduce systemic risk; and to promote the international and domestic competitiveness of the South African financial markets and of securities services in the Republic¹⁶⁰.

¹⁶⁰ Section 2 of the Financial Markets Act No. 19 of 2012.

A person should be a licensed exchange. An exchange means a person who constitutes, maintains and provides an infrastructure (a) for bringing together buyers and sellers of securities; (b) for matching bids and offers for securities of multiple buyers and sellers; and (c) whereby a matched bid and offer for securities constitutes a transaction¹⁶¹.

The Financial Markets Act should therefore be considered where securities are traded on an over-the-counter basis where the platform matches investors with issuers. According to De Beer (2014:45), a platform normally does not meet this requirement since there is only one seller (the project creator). The facilitator and the platform cannot be deemed to be an exchange and therefore the rules and regulations of this Act do not apply.

National Credit Act No. 34 of 2005

Loan-based crowdfunding will be subject to National Credit Act 34 of 2005 (NCA) (South Africa, 2005). A person who lends any amount will be required to be registered as a credit provider under the NCA (Shadrach-Razzino *et al.*, 2017). Part B, section 3(a) of the NCA states that one of the purposes of the NCA is “promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions”. This purpose corresponds with the NDP 2030 and appears to favour crowdfunding. However, section 4 of the NCA states that every credit agreement concluded at arm’s length (therefore excluding loans between family and friends) is subject to the provisions of the NCA. Also excluded from the NCA are loans to juristic persons (businesses) with an asset value or annual turnover of less than R1m¹⁶², but not if such a juristic person enters into a large agreement (i.e., for more than R250 000)¹⁶³.

¹⁶¹ Section 1 of the Financial Markets Act No. 19 of 2012.

¹⁶² Section 4(1)(a)(i) of the National Credit Act 34 of 2005.

¹⁶³ Section 4(1)(b) of the National Credit Act 34 of 2005.

Section 8(2)(c) excludes from the definition of credit agreement, a transaction between a stokvel and a member of a stokvel. A “stokvel” means a formal or informal rotating financial scheme with entertainment, social or economic functions, which-

- a) consists of two or more persons in a voluntary association, each of whom has pledged mutual support to the others towards the attainment of specific objectives;
- b) establishes a continuous pool of capital by raising funds by means of the subscriptions of the members;
- c) grants credit to and on behalf of members;
- d) provides for members to share in profits from, and to nominate management of, the scheme; and
- e) relies on self-imposed regulation to protect the interest of its members.

Section 10(1)(b)(iii) of the NCA classifies a credit agreement as a developmental credit agreement if it is entered into for the development of a small business. Section 41(2)(b) of the NCA provides that the National Credit Regulator may grant supplementary registration for such credit providers whereby certain statutory exceptions to the provisions of the NCA can apply.

Securities Transfer Tax Act No. 25 of 2007

A transfer of a security may be subject to securities transfer tax in terms of the Securities Transfer Act No. 25 of 2007 (South Africa, 2007). The definition of security includes any share or depository receipt¹⁶⁴ in a company, any member’s interest in a close corporation but does not include the debt portion in respect of a share linked to a debenture.

In the equity model, securities transfer tax will therefore be payable on the transfer of shares from the project creator to the funder at a rate of 0.25% of the taxable amount of

¹⁶⁴ No definition is provided in the Securities Transfer Act No. 25 of 2007 for a depository receipt. The Financial Markets Act No.19 of 2012, however, contains definitions, rules and regulations relating to a central securities depository.

the security¹⁶⁵. The project creator will have to pay the securities transfer tax on the amount or market value of the consideration given if the share is an unlisted security¹⁶⁶. The company is, however, entitled to recover it from the person to whom the security is transferred, i.e., the funder¹⁶⁷.

Law of contract

According to Bradfield (2018:1), the law of contract is entwined in every form of economic activity. Since crowdfunding is an economic activity, the law of contract will also apply to crowdfunding transactions. A detailed discussion of the law of contract is beyond the scope of this study. However, a few basic principles of the law of contract are highlighted to determine whether a crowdfunding transaction is a legally binding transaction.

A person cannot contract with himself and there will therefore only be a contract if it is entered into with two or more parties (Bradfield, 2018:28). Bradfield (2018:2) defines a contract as “An agreement (arising from either true or quasi-mutual assent) which is, or is intended to be, enforceable at law”. The doctrine of quasi mutual assent is explained as the “impossibility of ascertaining the subjective state of a person’s mind except by external manifestations” (Bradfield, 2018:31). In order to determine if the parties are truly in agreement, external manifestations and the words or actions of the other party should be judged (Bradfield, 2018:32).

It is important that the agreement provide certainty regarding the legal implications to all parties (Van der Merwe, Van Huyssteen, Reinecke & Lubbe, 2003:217). For a contract to be enforceable, the subject of the proposed contract should be sound in law (Van der Merwe *et al.*, 2003:187-188). A contract entered into for the sale of unlawful drugs will therefore not have a binding effect on the parties and neither party will acquire any rights or obligations in terms of such a contract.

¹⁶⁵ Section 2 of the Securities Transfer Act No. 25 of 2007.

¹⁶⁶ Section 6 of the Securities Transfer Act No. 25 of 2007.

¹⁶⁷ Section 7 of the Securities Transfer Act No. 25 of 2007.

It is not necessary for all contracts (unless statutorily obliged) to be reduced to writing for them to be valid and legally binding (Bradfield, 2018:123). The parties should enter into a contract of their own free will and should not have been forced in any way to enter into a contract (Van der Merwe *et al.*, 2003:119).

There is agreement if there is an offer and an acceptance of that offer (Bradfield, 2018:36). An offer is the intention to be legally bound by the acceptance thereof of the offeree (Bradfield, 2018:37). It is important that performance offered when the agreement was entered into, is objectively possible (Van der Merwe *et al.*, 2003:182). Acceptance of the offer must furthermore be clear and unambiguous (Bradfield, 2018:74).

When applying the above principles to crowdfunding transactions, it can therefore be said that the project creator is making an offer to any funder or funders when publishing the project on the platform. In rewards-based crowdfunding, the reward (product or service) offered is the performance offered by the project owner in terms of the law of contract. The project owner must therefore ensure that performance is attainable and possible. By contributing to the project, the funder accepts the offer and a legally binding agreement comes into existence.

6.3.3.2 Tax implications

Funding received

The amounts received are capital in nature (and therefore not taxed) since they are amounts paid for the acquisition of a capital asset (a share).

The project creator issues shares and declares dividends from its after-tax profits. The dividend paid is not deductible since it is declared from after-tax profits and therefore capital in nature. If the company is a South African company, the company will have to withhold dividends tax from the cash dividends declared to its shareholders at a rate of

20%. If the dividend was declared as a dividend *in specie*, the dividends tax will have to be paid by the company declaring the dividend.

Funding provided

The funder buys shares on which the funder will receive dividend income in return. The acquisition cost of the shares is not deductible since it is capital in nature. This is in contrast to the existing deduction allowed for a VCC under section 12J (see section 6.2.3). The funder will have to pay capital gains tax when the shares are sold. If the funder is a share dealer, the proceeds from the disposal will not be capital in nature and will be included in the gross income of the funder. The share dealer will be allowed to claim a deduction for the acquisition cost of the shares. However, if the shares are only sold after three years since the date of acquisition of the shares, section 9C deems the gain to be capital in nature. This is the case even if the funder is a share dealer. The gain will then be subject to capital gains tax.

The dividend income should be included in the gross income of the funder in terms of the definition of gross income¹⁶⁸. The dividend will be exempt from normal income tax in terms of section 10(1)(k) of the ITA if it is declared by a South African company. The natural person shareholder will, however, have to pay dividends tax at a rate of 20% on the dividend received.

Sections 8E – 8F contain special provisions dealing with so-called “hybrid” equity and debt instruments.

6.3.4 The crowdfunding platform

As previously stated, crowdfunding platforms charge fees for services rendered. Most platforms also limit their liability and responsibility regarding the funder. This is done by

¹⁶⁸ Paragraph (k) of the gross income definition in section 1 of the Income Tax Act.

stating that the contract is between the project creator and the funder and not with the platform.

The income tax consequences of the platform will be the same, regardless of the crowdfunding platform used. The platform merely acts as an intermediary receiving fees for services rendered. Crowdfunding platforms have in general three revenue sources: (1) interest on money received and not yet paid to the project creators; (2) charges for additional services rendered such as payment handling fees and fees for making diagnostics available; and (3) transaction fees which are sometimes conditional upon the success of the campaign (Belleflamme *et al.*, 2015:17). These fees will be gross income in terms of paragraph (c) of the gross income definition. Interest earned on money received and not yet paid to the project creators will also be included in gross income. The platform will be able to claim expenses such as bank charges, salaries, rent etc. as tax deductions in terms of section 11(a) of the ITA if it can be argued that the platform is carrying on a trade.

It is also possible that the platform is registered as a public benefit organisation. Public benefit organisations are exempt from paying income tax in terms of section 30 of the ITA. The amounts received for services rendered will then not be included in gross income. Funders might furthermore be eligible for the section 18A deduction for donations made to projects (see section 6.3.1.1).

6.4 CONCLUSION

There are currently no established policies in South Africa specifically referring to crowdfunding. There is also no tax legislation in South Africa specifically designed for crowdfunding transactions. The lack of specific policies relating to crowdfunding and the need for research specifically regarding the tax implications of crowdfunding were referred to under the rationale for this study (see section 1.3) with reference to the following extracts:

As it stands, the activity of crowdfunding is not regulated in South Africa, there is no specific mention of 'crowdfunding' in any piece of legislation, nor is there any proposal of legislation in the pipeline. (Mashinini, 2016)

The question is whether the regulation of equity crowdfunding will kill the initiative in its tracks. There is definitely a place for capital raising in this manner in the South African market, but creating a cost-effective platform that addresses the risks involved while still providing a streamlined alternative for capital raising will prove to be no small task. (Laubscher, 2016)

There are currently no bills or discussions that pertain to defining tax legislation for online crowdfunding in South Africa. (Stevenson, 2011:13)

It has been confirmed in this chapter that the legislation consulted did not explicitly refer to crowdfunding. It was furthermore determined that, since there are no specifically designed tax provisions for crowdfunding transactions in South Africa, the tax implications of crowdfunding transactions are not always certain.

Existing ITA provisions addressing investments in small businesses are available if the funding is done through another entity such as an SBFE or through a venture capital company. It is therefore not applicable in a crowdfunding transaction where the purpose is for issuers to invest directly in the crowdfunding project. The platform will have to register as an SBFE (complying with all of the requirements and being created for a specific purpose (type of projects) only then. Furthermore, no deduction is available to the funder of the SBFE.

One of the main characteristics of crowdfunding is that it is an open call to anybody to invest directly in the project in order to minimise costs. The SBFE and venture capital provisions are therefore not complying with the characteristics of crowdfunding.

The ITA does not contain specific provisions addressing crowdfunding transactions for any of the identified crowdfunding models, nor has SARS issued any guidance on the

tax implications of crowdfunding transactions. The taxation of all models is therefore determined by using existing tax laws, some of which were promulgated many years ago. There are no tax incentives to encourage crowdfunding as has been seen in the UK and Australia. The lack of tax incentives might discourage investors from investing in crowdfunding projects and thereby not assisting in the government's goal of encouraging small business formation in order to encourage job creation.

Within the current ITA two main issues were identified and need to be considered in order to determine the tax implications of crowdfunding transactions. These are whether or not the amounts received and paid are of a capital nature, and whether or not a trade is being carried on by the project creator. Neither of these terms are defined in the ITA and numerous court cases have addressed these components in the past. This therefore increases the uncertainty in determining the tax implications of crowdfunding transactions.

All funding received by the creator will be taxable unless it is of a capital nature. By being subject to income tax, the already limited amount of funding that is available to the project creator to set up the business, is automatically decreased. This is contrary to existing more favourable provisions contained in the Small Business Funding provision (see section 5.2.1) as well as the Venture Capital provisions (see section 5.2.3.). As discussed, the provisions referred to in sections 5.2.1 to 5.2.3 were introduced to encourage small business creation. New funding opportunities in the form of crowdfunding, however, started being used after the introduction of those provisions which are not treated similarly and therefore not supportive of government's aim, or of the principle of fairness of a good tax system. Crowdfunding eliminates costs by bypassing the "middle man" and encouraging members of the general public who might not otherwise be able to invest in businesses due to various constraints, to invest in a new business. By using other vehicles such as VCCs and small business funding entities, more "middle man" entities are involved, and investors cannot invest directly in the SMME.

Crowdfunding combines various elements and participants in the existing securities and regulation market in an original way. This results in participants being exposed to regulation that they might not even be aware of. As was seen in section 6.3.3.1, it is not always clear or easy to determine whether or not crowdfunding falls within the ambits of other Acts.

In order to use equity crowdfunding, entrepreneurs must comply with the requirements of the Companies Act. This requires that they must take on a corporate form designed for more sophisticated, larger entities, in order to comply with the regulatory framework.

These uncertainties could unduly increase the administrative and compliance costs of start-ups. They could further result in crowdfunding transactions and structures being created solely to circumvent the regulation of the other Acts. They could also result in crowdfunding being misused in the form of schemes and structures which do not adhere to the crowdfunding model as defined and as characterised in Chapter 2. This could have unintended consequences such as overregulation, increased compliance costs etc., for all “traditional” crowdfunding projects. They could also increase the risk of tax evasion and tax avoidance.

The next chapter will discuss the empirical research results from the interviews.

CHAPTER 7: RESULTS FROM THE INTERVIEWS

7.1 INTRODUCTION

The first phase of this research study was conducted by means of the collection and analysis of qualitative secondary data gained from a scientific database analysis and library research. This included a study of appropriate sources containing authoritative publications, books, journals, the Internet and official documents such as policies, to gather information on the various crowdfunding models, tax and other regulation implications of crowdfunding. This established a global theoretical platform for the study.

In this phase, the different models of crowdfunding were explained, together with the advantages and risks thereof. The body of available literature on crowdfunding consists mainly of studies conducted internationally, since no significant study from a South African viewpoint could be identified. International developments on crowdfunding with reference to the USA, UK, Australia and New Zealand were also reviewed. Furthermore, policy considerations underpinning crowdfunding in South Africa were discussed. An evaluation of the current SA income tax provisions was then performed. Data was furthermore obtained through online observations and monitoring of selected SA crowdfunding platforms. The data obtained from a South African viewpoint was used to determine, to a basic extent, whether the dynamics of crowdfunding in South Africa are similar to those internationally.

A qualitative research approach, however, does not only consist of documentary sources but also of the perspectives and beliefs of other role-players (Joubert, Hartell & Lombard, 2016:110). According to Mouton (2001:180), the main sources of error associated with a literature review are “selectivity in the sources; unfair treatment of authors; misunderstanding the source; selective interpretation to suit one’s own viewpoint; poor organisation and integration of review”. Interviews were conducted with relevant role-players in crowdfunding transactions to gain insight into the crowdfunding industry from a South African viewpoint (see Annexure A). The interviews were conducted with the founders of four of the main South African crowdfunding platforms,

in order to determine their experiences with crowdfunding and their reasons for making use of crowdfunding.

An interview was conducted with Derek Whitehead (chief operations director and one of the founders) of Jumpstarter on 16 April 2020. An interview was also conducted with Patrick Schofield (founder of Thundafund and BackaBuddy and the co-founder of Uprise.Africa) on 22 April 2020, which was continued on 29 April 2020. Patrick Schofield is also occasionally referred to as the father of crowdfunding in South Africa (Duggan, 2018). Both interviewees welcomed and commended the fact that the topic of this thesis deals with the taxation of crowdfunding. This supports the rationale for this study as was explained in Chapter 1 (section 1.3).

7.2 RESULTS

The questions and information obtained from the interviews, are listed below.

7.2.1 What are the different crowdfunding models? (Addressing research question 1)

1. Which crowdfunding model(s) does your platform support?

Table 14: Crowdfunding model that the platform supports

Crowdfunding model	Jumpstarter	Thundafund	BackaBuddy	Uprise
Donation	Yes	No	Yes	No
Reward	Yes	Yes	No	No
Equity	No	No	No	Yes

According to Derek Whitehead, crowdfunding (specifically in Africa) is inspired by the structures of international platforms such as Kickstarter and Indigogo. The African crowdfunding platforms are getting a more structured framework into the African continent (where there is a lot of potential) because of the lack of regulation.

The main crowdfunding model supported by Jumpstarter is rewards-based crowdfunding. This is because it is believed that someone needs an incentive to open their projects. However, donation-based crowdfunding is also supported to a lesser extent. Jumpstarter was inspired by the international platform, Kickstarter, in 2010. This is also evident in the comparison of platform information done in a previous chapter (see Table 4).

Both Jumpstarter and BackaBuddy are registered NPCs. Jumpstarter was initially registered as a close corporation, but was converted to an NPC. Derek Whitehead submitted that it was easier to register the company as an NPC because of the red tape associated with companies that are not registered as NPCs. Also, by registering as a non-profit company, Jumpstarter gained access to various benefits, such as connection to big, so-called blue-chip, companies, and free subscriptions to certain websites and software. It also allowed them to get a Google-advert credit which allows them to reach the international market. An NPC also has a lesser regulatory burden, including in relation to tax compliance, as it is exempt from income tax. According to Schofield, BackaBuddy is registered as an NPC because it supports the purpose of the platform, being a donation-based platform for charitable causes.

According to Patrick Schofield, the structure used by Uprise.Africa is complex and expensive because of financial regulatory requirements in SA. The structure of Uprise.Africa comprises five companies. According to Schofield, an equity crowdfunding project is feasible for raising R3 million or more. Uprise.Africa Fund Limited is a public company with different classes of shares. For every project, a new class of shares is issued in Uprise.Africa Fund Limited, specifically for that project. This company has in turn a single shareholding in the company in which the funders invest. Each class of shares in Uprise.Africa Fund Limited is held solely by the funders of a specific project. The shares in each of the projects are therefore held by the funders through Uprise.Africa Fund Limited. Uprise Markets (Pty) Ltd is an-FSCA registered private company and is therefore allowed to promote the shares for investment into a public company. The Uprise.Africa Holding Company (Pty) Ltd owns all the shares in Uprise.Africa Crowd (Pty) Ltd and Uprise Management Company (Pty) Ltd.

Uprise.Africa Crowd (Pty) Ltd is an operational company which provides advertising services on behalf of Uprise Management Company (Pty) Ltd, which in turn provides the oversight function. Uprise has furthermore partnered with ZARX, which creates a secondary market for the shares. According to Schofield's knowledge, Uprise is the only equity-based crowdfunding platform that is currently operational in SA.

This complex structure required for equity crowdfunding, as well as the statement that it was easier to register as an NPC, supports the findings in Chapter 6 (refer to section 6.3.3) that equity crowdfunding falls under various acts, with different rules and regulations that need to be adhered to.

2. Please motivate why your platform chose the specified model(s).

Table 15: Reason for support of the crowdfunding model of the platform

Crowdfunding model	Jumpstarter	Thundafund	BackaBuddy	Uprise
Donation			Founder is passionate about helping people to reach their dream and this platform supports kindness and the community.	
Reward	An incentive encourages people to contribute.	Founder is passionate about helping people to reach their dream and this platform		

Crowdfunding model	Jumpstarter	Thundafund	BackaBuddy	Uprise
		drives entrepreneurship.		
Equity				This platform enables people to “get a foot hold in the large-scale unicorn” (Patrick Schofield).

It is evident from Table 15 above that the main reason for the creation of the donations and reward-based crowdfunding platforms, is to help people and entrepreneurs (small businesses). The purpose of Jumpstarter is to help people in SA to raise money for their project, regardless of whether the project is for profit or charity. People are wary of pledging their money online. An incentive makes it easier to give money if you know that you will get something back from a project in which you have an interest. The fact that Jumpstarter is a registered NPC, builds trust.

According to Schofield, crowdfunding democratises access to finance and in many ways complements traditional financial players. Previously, generating money from the public would require the registration of a public listed company through an exchange, which is very expensive. Crowdfunding disrupted various spaces related to financial technology as it gives people the ability to access a vast audience at a relatively low cost.

The entry point for Patrick Schofield into the crowdfunding market was the creation of Thundafund. According to him, Thundafund is similar to Kickstarter and was created with the purpose of building enterprises and industries. The aim of Thundafund, therefore, was to build entrepreneurship and innovation. BackaBuddy was thereafter created since it was realised that there is a massive need for charity support in SA. According to Schofield, this is because social giving underpins the sustainability of SA’s

economic system. Uprise.Africa was born out of a purely philosophical standpoint by taking the fourth industrial revolution into consideration. Schofield explained that the ability of ordinary people to invest in a company such as WhatsApp or Facebook would not have been possible in the past since these were mainly VCCs etc. that invested in and controlled that investment market. This led to a massive concentration of wealth in the hands of a very few investors. Equity crowdfunding opens up the opportunity for the general public to take the risk of investing during an early stage in companies that might become hugely successful, such as WhatsApp and Facebook.

It was therefore determined that, even for the founders of the platforms, the main reasons were not only to gain a financial benefit, but to provide community benefits, to drive entrepreneurship and to gain intrinsic benefits such as assisting others to reach their dreams (see section 2.4).

3. From which date has your platform been active?

Table 16: Date from which platform has been active

Jumpstarter	Thundafund	BackaBuddy	Uprise
Registered in 2012 as a close corporation, launched on the web early 2015.	2013	2015 and registered as NPC in 2016.	2017

From the above dates, it is evident that formal crowdfunding platforms have only been active since about seven years ago. However, based on the statistics obtained from the websites of the platforms (see section 2.2.1, Table 2 and Table 3), it is evident that crowdfunding is growing rapidly in SA.

4. Can project creators who are not SA residents also create a project on your platform or is it restricted to SA residents only?

Table 17: Residency of project creators who use the platform

Jumpstarter	Thundafund	BackaBuddy	Uprise
Residents and non-residents but currency is Rand.	Residents and non-residents but currency is Rand.	Residents and non-residents but currency is Rand. It is recommended that the project creator has a SA bank account.	Residents only.

Since crowdfunding uses the Internet, residents and non-residents can use the SA-based platforms (with the exception of the equity crowdfunding platform, Uprise.Africa). Crowdfunding therefore needs to be regulated in order to avoid SA base erosion. According to Derek Whitehead, the projects registered on Jumpstarter are mainly those of individuals or small companies.

5. Can funders who are not SA residents also contribute to projects on your platform or is it restricted to SA residents only?

Table 18: Residency of funders who use the platform

Jumpstarter	Thundafund	BackaBuddy	Uprise
Residents and non-residents but currency is Rand.	Residents and non-residents but currency is Rand.	Residents and non-residents but currency is Rand.	Residents only or you have to have an SA proxy if you are a non-resident.

Since crowdfunding uses the Internet, residents and non-residents can use the SA-based platforms (with the exception of the equity crowdfunding platform, Uprise.Africa). Crowdfunding therefore needs to be regulated in order to avoid SA base erosion.

6. Which procedures and documentation do you require when dealing with a prospective project creator?

For Jumpstarter, there is no formal documentation that must be submitted. However, in order to create a project, you must register on the platform and provide certain information before the project is placed live on the website. The information required includes the goal amount as well as the period for which the project will be open in order to reach the goal amount. Projects are only allowed to run for a maximum of 60 days since it has been found that funding fizzles out after this. Information is also needed about what the project is, who the person involved is, how he/she plans to drive it, why he/she created the project, and what his/her background is. It was found that this information is important to provide since people like to see what they are getting involved in. A key component is the reward offered (preferably a minimum of three rewards) and featured images of the project as well as the reward. A video is advisable but not compulsory.

According to Derek Whitehead, fraud is limited since crowdfunding is a public act which allows everyone to see whether it is real or not. The all-or-nothing approach (where money is retained and handled by Jumpstarter through their merchant account) also assists in ensuring that projects are not fraudulent. The funders are also allowed to request a refund of their pledged amount (which is paid out minus a small administration fee). Alternatively, the funder can obtain a credit which he/she can use to pledge on other projects on the platform.

For BackaBuddy, it is preferred that project creators are either a registered NGO or linked to a registered NGO. The NGO must provide their registration documents. If the project creator is not an NGO, they are required to provide at least three Facebook profiles (friends) which should be linked and listed to the project, are publically recognised and who can be contacted to verify the project. The profiles should not have been created during the last three months since this immediately raises a red flag. This is referred to as social referencing and social vetting and was also confirmed by Derek Whitehead to be effective in combatting fraud.

For Thundafund, standard verification procedures are followed such as that the company registration documents should be provided if it is a company, and bank confirmation must be submitted for payment. Reliance is placed heavily on social vetting, an approach similar to that followed by BackaBuddy.

For Uprise.Africa, the regulation is much stricter and all projects first go through a full verification and vetting process before a project is approved. The verification, financial and legal due diligence processes followed are similar to that followed by VCCs.

7. Which procedures and documentation do you require when dealing with a prospective funder?

For all three platforms (Jumpstarter, Tundafund and BackaBuddy), there are no specific formal documents that must be submitted. Anybody can make contributions through the online pay system. The payment information must be submitted, which is verified.

Investors in equity crowdfunding need to go through a verification process to determine if there are politically connected parties. There is also a declaration that investors need to read, to declare that they are not investing more than a certain percentage of their annual income and that they are aware of the risks.

8. Which regulations/laws/acts are applicable to your platform?

Since Jumpstarter is a non-profit company, the applicable legislation is limited to that of a non-profit company which is mainly the Companies Act. Jumpstarter is not a bank since the money is merely held in an account for a maximum of 60 days and is paid over to the project owner if the funding goal is reached. If the funding goal is not reached, the money is refunded to the funders. The payment process is performed by PayGate. The same applies to Thundafund and BackaBuddy. Furthermore, these platforms need not comply with the regulations of the FSCA, as was confirmed in Chapter 6 (see section 6.3.3.1).

However, Uprise.Africa needs to comply with the Companies Act as well as the FSCA. Jumpstarter and Uprise.Africa have also partnered with the African Crowdfunding Association for regulatory purposes. According to Whitehead, they deal with financial institutions around Africa. Although the African Crowdfunding Association is not an official regulator of crowdfunding, it is developing policies and providing advice to platforms regarding regulation of crowdfunding in Africa.

According to Schofield, the FSCA has contacted Uprise.Africa and is busy doing research in terms of regulating equity crowdfunding, but no formal regulations explicitly applicable to crowdfunding are yet in place.

9. What are the challenges that you experience with regard to the regulation of crowdfunding transactions?

Derek Whitehead submitted that the regulations pertaining to crowdfunding are a grey area globally. Initially there were a lot of challenges which were mainly overcome by registering as a non-profit company.

According to Patrick Schofield, most challenges lie with equity crowdfunding since many regulations exist to protect the public.

10. What are the risks that you have to deal with?

Crowdfunding is public act and therefore the risks are minimal. Also, Jumpstarter is only the facilitator between the project owner and the funder and does not carry the risk. According to Schofield, money laundering is not a risk when dealing with a registered charity. The platforms contain a risk statement, warning funders of the risks associated with crowdfunding. However, as a director of Uprise.Africa, Schofield explained that the risks of non-compliance with the Companies Act are placed on the directors. Furthermore, the platforms bear a reputational risk if a project is fraudulent.

According to Schofield, money laundering is not a huge risk with donation or rewards-based crowdfunding since the money goes to the charity or the project and is not returned to the investor (unless the goal amount is not reached). Schofield however mentioned that they had had a few cases where people wanted to set up a charity simply to contribute a huge amount and then withdraw it immediately. This is not allowed since it is an indication to them of possible money laundering.

11. What type of income do you receive as platform from the following participants and how is the income calculated?

- a. From the *project creator*
- b. From the *funder*

For Jumpstarter, the income is derived from administration fees charged which is 7% and 3.5% for projects which are registered as non-profit organisations. For Thundafund (7%), BackaBuddy (6%), and Uprise.Africa (8%), the fees charged relate to an administration fee and a platform fee. These fees were also obtained in Table 4 (see section 2.2.2) where the information of the platforms of Jumpstarter and Thundafund, as retrieved from the online website, was compared to that of the USA-based, Kickstarter platform.

12. What type of expenses do you incur as a platform?

The main expenses are interest incurred on loan accounts (for Jumpstarter specifically), which was incurred in creating the platform. Other costs include monthly fees charged on the merchant bank account, pay system fees, website hosting fees and running expenses such as salaries for project administrators and marketing.

From the two questions above, it is evident that the types of income and expenditure received/incurred by the platforms, are similar regardless of the crowdfunding model used i.e., donation or rewards-based crowdfunding.

7.2.2 What are the reasons and background for using crowdfunding? (Addressing research question 2)

1. Do you think crowdfunding will remain/increase/disappear in future? Please explain.

With the acceleration in the technology market and access to digital tools, crowdfunding will increase. According to Derek Whitehead, it is also a funding model used globally. Patrick Schofield is of the opinion that, even though crowdfunding might not necessarily be called “crowdfunding” in the near future, the practice will continue to exist and will expand.

The interviewees are therefore both of the opinion that crowdfunding will remain relevant and will increase in future. This view is supported by Table 1, which shows the increase in Internet users as well as Table 2 and Table 3, which show the increase in the use of crowdfunding over a number of years.

2. What, in your opinion, is the main reason for project creators to use crowdfunding?

According to Derek Whitehead, it depends on the project and crowdfunding model used, but the main driver for using crowdfunding is to receive funds. According to Patrick Schofield, crowdfunding is seen by people using Thundafund as a powerful marketing tool and to build a customer base. It is furthermore a more feasible and low-cost manner of raising funds. Crowdfunding furthermore makes it easier and a more respectful way to ask for funding without creating expectations since you do it via the Internet.

These findings therefore support the findings in section 2.4 regarding the reasons for using crowdfunding even in SA.

3. *What, in your opinion, is the main reason for funders to contribute to projects?*

It depends on the crowdfunding model used. With the rewards-based model, the offer of the incentive is the main reason for people to “open up their wallets” and to pledge money. According to Schofield, funders get recognition/social awareness when they make a contribution/donation. Making contributions through crowdfunding is furthermore easy and certainly not a complex process.

These findings therefore support the findings in 2.4 regarding the reasons for using crowdfunding even in SA.

4. *What are the advantages of using crowdfunding?*

It was found that this question is a duplication of the previous questions which dealt with the advantages of using crowdfunding.

5. *What are the disadvantages of using crowdfunding?*

The main disadvantage identified was that it might be difficult to determine whether the project is a “real” project, although the payment processor system (all-or-nothing model) helps to prevent possible fraud. Amounts are only paid out if the goal amount has been reached. If the goal amount has not been reached, the funders are refunded.

7.2.3 *What are the tax implications of the different crowdfunding models currently in South Africa? (Addressing research question 4)*

1. *Are you familiar with the tax consequences of crowdfunding for the following participants? Please explain.*

- a. Project creator
- b. Platform
- c. Funder

It was determined that the founders are not that familiar with the income tax consequences, making it difficult to answer this question. Furthermore Jumpstarter and BackaBuddy are registered as non-profit companies where income tax is not applicable. It was determined that BackaBuddy is a registered VAT vendor. VAT is, however, beyond the scope of this study.

2. Do you think that the current tax legislation of South Africa encourages or discourages crowdfunding? Please explain.

It was determined that there is room for improvement to encourage crowdfunding in South Africa, especially from a tax perspective. Income tax legislation can be expanded to encourage crowdfunding by providing certain income tax incentives for investors.

3. Do you think crowdfunding should be taxed, and if so, how? Please explain.

Derek Whitehead stated that it depends on the platform and the crowdfunding model used. If it is donation-based crowdfunding it should not be taxed. Rewards-based crowdfunding is a bit of a grey area, according to Whitehead. Equity and debt-based crowdfunding could possibly be taxed.

As a final remark, Patrick Schofield applauded the aim of this study and commented that a tax framework, clearly indicating the tax implications of crowdfunding in SA, could be a great service that this study could provide to humanity in general. This statement of Schofield supports the rationale for this study as indicated in Chapter 1 (see section 1.3).

7.3 CONCLUSIONS FROM INTERVIEWS CONDUCTED

From the interviews conducted with the platform founders, the following data was collected with regard to the research questions:

What are the different crowdfunding models? (Addressing research question 1)

It was determined that Jumpstarter and Thundafund support donation and rewards-based crowdfunding, BackaBuddy supports donation-based crowdfunding and Uprise.Africa is South Africa's first equity crowdfunding platform.

Most of the existing regulations are applicable to equity crowdfunding. Due to various regulations, Uprise.Africa had to follow a complex five-company structure to adhere to regulations, such as the Companies Act and those of the FSCA.

From the funding amounts raised, it is evident that crowdfunding is a growing industry in South Africa. The founders are both of the opinion that the crowdfunding industry will continue to exist and will grow in future.

What are the reasons and background for using crowdfunding? (Addressing research question 2)

The main reason why project owners use crowdfunding is to obtain funding. This is an easy way for project owners to "ask" for funding without having to face anybody in person. For funders, the offer of an incentive, such as with rewards-based crowdfunding, is the main reason for people to "open up their wallets". Furthermore, social recognition is also an incentive for a funder to make a contribution. The simplicity in the process of crowdfunding, making a contribution through an electronic platform, furthermore aids in simplifying the process for funders to use crowdfunding to make contributions/donations.

The researcher had wanted to obtain specific data for statistical purposes from the platforms, such as the number of projects to date, the number of successfully funded projects, total amount of funding raised, crowdfunding model used by the projects, geographical location of the successfully funded projects, geographical location of funders and the relationship of funder to project owner (i.e., friend, family, non-related). It was however not possible to obtain information other than the information available on

the online websites which were used and referred to in previous chapters. However, it was nevertheless found that the results from the interviews and survey questionnaire (see the next chapter) were sufficient for the purposes of this research. Further empirical results can be performed in future research.

What are the tax implications of the different crowdfunding models currently in South Africa? (Addressing research question 4)

The founders are aware but not sure of the basic tax implications. As they are not tax specialists, they do not have a thorough knowledge of taxation. Jumpstarter and BackaBuddy are exempt from tax due to their non-profit status. Jumpstarter supports rewards-based crowdfunding whereas BackaBuddy is a donation-based crowdfunding platform. The reason provided for Jumpstarter's NPC status was that this entitled the founders to other global benefits, including less regulatory compliance. Although Jumpstarter supports rewards-based crowdfunding, in contrast to BackaBuddy which support donation-based crowdfunding, both are registered as NPCs.

From the results of the interviews as well as the discussion in Chapter 2, it is evident that crowdfunding in SA is similar to crowdfunding internationally. Jumpstarter and Thundafund show similarities to the internationally studied platform, Kickstarter (refer to the table of comparison in Chapter 2). Crowdfunding is still in its infancy in South Africa but is rapidly growing. The use of the Internet makes it possible for residents and non-residents to participate in crowdfunding (both as project creators and as funders), making it an open call to anybody. Rules and regulations need to be adhered to in order to avoid base erosion of the SA economy. These rules and regulations need to be clear, simple to adhere to, and not so stringent that they will discourage the use of SA platforms. The fact that residents and non-residents are allowed to use the platforms might result in their simply using a non-SA platform in order to circumvent any stringent rules and regulations, which also might result in erosion of the SA economy and the loss of valuable entrepreneurship.

The next chapter will discuss the research results from the questionnaire addressed to respondents.

CHAPTER 8: EMPIRICAL RESULTS

8.1 INTRODUCTION

The second phase of the research design is quantitative in nature, with the intention of determining the relevance of the findings of the first phase among a broader sample of respondents, in a South African context. The findings obtained from the interviews with the platform founders, together with the information obtained from the global research, were used to develop a survey instrument (see Annexure B).

8.2 DEVELOPMENT AND IMPLEMENTATION OF THE QUESTIONNAIRE

The questionnaire was developed in Microsoft Word. It was thereafter reviewed by a research expert at the University of South Africa. The questionnaire was then converted to a web-based questionnaire through the EvaSys-software of the University of the Free State. An electronic link to the questionnaire was sent to two platform creators who agreed to make the electronic link available for respondents to access the web-based questionnaire. The researcher would like to acknowledge the assistance received from the platform founders and administrators of Jumpstarter and Thundafund who made the electronic link available. Thundafund added the link to all of their outgoing correspondence and Jumpstarter added the link to their online newsletter (25 July 2020). The link to the questionnaire was also made available and shared publically on the Facebook profile of the researcher. Respondents accessed the questionnaire through the link and completed the questionnaire electronically. Responses received up to 30 September 2020 were used.

8.3 COMPLETION OF THE QUESTIONNAIRE

The privacy and anonymity of all participating respondents were assured as they were not required to provide any information that could possibly identify them. The fact that a web-based questionnaire was used, contributed towards the privacy and anonymity of respondents.

Since the link was an open call to anybody to participate, the size of the population could not be determined and included every funder, potential funder, project owner or potential project owner. As at 21 July 2020, the following data was observed from the two platforms:

Table 19: Platform statistics

Information	Jumpstarter	Thundafund
Number of projects	24	1 224
Funding raised	R938 615.22	\$3 240 657
Number of supporters	Not available	22 513

8.4 LIMITATIONS AND PRACTICAL PROBLEMS REGARDING THE EMPIRICAL STUDY

The number of responses received from the survey instrument was very low (only 39 responses). However, the collection of quantitative data builds on the first phase. As explained by Creswell (2014:226) and mentioned previously, the exploratory sequential mixed method design allows the generalisation of data from a few individuals to a larger sample. Therefore, even though only 39 responses were received, data obtained in the first phase, can be generalised to a larger sample obtained in the second phase. It is recognised that non-response bias might impact the results. However, the results obtained from the questionnaire were used to gather information on the crowdfunding landscape in South Africa. The conclusions and recommendations made in this study, were also not mainly based on the results of the questionnaire since a mixed method design was followed.

Furthermore, some questions were not completed by some respondents. As the purpose of the questionnaire was merely to get an indication of the crowdfunding landscape in South Africa, incomplete questionnaires were not discarded. Furthermore, the questions were not interrelated and the lack of response to one question, did not have a material effect on the response to another question.

8.5 DEMOGRAPHICS OF RESPONDENTS

To ensure that responses from a sample that was representative of South Africa was used, it was important to establish certain demographic information pertaining to the respondents. Demographic information was obtained regarding the following:

- gender;
- age group in years;
- race;
- whether or not a South African resident;
- province where currently located; and
- field in which currently occupied.

8.5.1 Gender of respondents

In total 39 respondents fully completed the web-based questionnaire. The sample consisted of an almost equal number of male and female respondents. There were 20 male respondents and 19 female respondents. These results are reflected in Table 20.

Table 20: Gender of respondents

Gender	Number of responses	Percentage
Male	20	51%
Female	19	49%
TOTAL	39	100%

8.5.2 Age group of respondents

The respondents were requested to indicate in which age group they fell. One respondent did not divulge his age. The omission was not significant to the study, however, and will not have a material effect on the average group determined or the results of the other questions. The majority of respondents (68,42%) were in the age groups of 40 years or younger. Their responses are reflected in Table 21.

Table 21: Age group of respondents

Age group	Number of responses	Percentage
20-30	17	44,74%
31-40	9	23,67%
41-50	4	10,53%
51-60	4	10,53%
60+	4	10,53%
TOTAL	38	100%

Ron Suber, the president of Prosper Marketplace, America's first peer-to-peer lending marketplace, stated that:

...for the first time in history, we're seeing a collision between Wall Street and Silicon Valley and the banking industry, and this is driven by the Gen X, Gen Y, and Millennials' need to do things in a different way. They're used to sharing so much on the Internet, and now they want to borrow and lend on the Internet. I think it's a trend that's irreversible. These young people aren't going back to the old way, the way their parents moved money and paid for things and borrowed and lent. (Assenova et al., 2016:34-35)

Even though Ron Suber was referring to one specific crowdfunding model (debt-based crowdfunding), he was nevertheless referring to crowdfunding. Based on the age of the respondents that completed the questionnaire, it is evident that in South Africa too, Generation Y and Z are most familiar with crowdfunding, have participated in crowdfunding and will continue to participate in crowdfunding (see section 8.7.3).

8.5.3 Race of respondents

It was important to establish the race of the respondents to determine if the respondents represented the demographics of South Africa. Responses were obtained from respondents active in all race groups, making the sample fully representative. Their responses are in Table 22.

Table 22: Race of respondents

Race	Number of responses	Percentage
Black	15	38,46%
Coloured	3	7,69%
Indian	2	5,13%
White	19	48,72%
TOTAL	39	100%

8.5.4 Province where currently located

The sample was fully representative of South Africa on a provincial level, since responses were obtained from respondents active in all the South African provinces. Western Cape-based respondents comprised 23,08% of the total respondents, followed by Gauteng (20,51%) and the Free State and KwaZulu-Natal (with 17,95% each) as indicated in Table 23.

Table 23: Location of respondents

Province located	Number of responses	Percentage
Eastern Cape	1	2,57%
Free State	7	17,95%
Gauteng	8	20,52%
KwaZulu-Natal	7	17,95%
Limpopo	2	5,13%
Mpumalanga	1	2,56%
North West	1	2,56%
Northern Cape	1	2,56%
Western Cape	9	23,08%
Nairobi	1	2,56%
Nigeria	1	2,56%
TOTAL	39	100%

8.5.5 Main field in which occupied

Respondents were required to indicate the main field in which they were currently occupied. Their responses are indicated in Table 24.

Table 24: Field of occupation of respondents

Field of occupation	Number of responses	Percentage
Construction	0	0,00%
Education	7	17,95%
Entrepreneur	6	15,39%
Financial	6	15,39%
Private sector	6	15,39%
Public sector	2	5,13%
Pensioner	2	5,13%
Personal service provider	1	2,56%
Student	2	5,13%
Religion	1	2,56%
Health care	1	2,56%
Non profit	2	5,13%
Go getter	1	2,56%
Hospitality	1	2,56%
Volunteer	1	2,56%
TOTAL	39	100%

The majority of respondents indicated that they were occupied in the field of education (17,95%), followed by the field of entrepreneurship, the financial industry and the private sector (each 15,39%). However, responses were obtained from respondents active in other industries as well, making the sample representative of most industries. This, together with their past participation and prospective participation in crowdfunding (see section 8.6.3), is an indication that crowdfunding is an open call to any member of the public, regardless of their main area of economic activity in South Africa.

8.5.6 Level of financial literacy

Respondents were required to indicate their level of expertise in investments and investment decision making. Their responses are indicated in Table 25. One respondent did not complete this question. The omission is, however, not significant to the study and will not have a material effect on the average level determined or the results of the other questions.

Table 25: Level of financial literacy of respondents

Level	Number of responses	Percentage
Fundamental awareness (basic knowledge)	11	28,95%
Novice (limited experience)	7	18,42%
Intermediate (practical application)	13	34,21%
Advanced (applied theory) (recognised authority)	6	15,79%
Expert	1	2,63%
TOTAL	38	100%

The majority of respondents (81,58%) indicated that their level of financial literacy with regard to investment decisions was intermediate or lower. Their level of financial literacy together with their past participation and prospective participation in crowdfunding (see 8.6.3) is an indication that crowdfunding is an open call to any member of the public regardless of their demographics or financial literacy in South Africa.

8.5.7 Link to the questionnaire

It was determined that the link to the questionnaire was mainly received from the crowdfunding platform. The responses are indicated in Table 26.

Table 26 : Source of link to the questionnaire

Source	Number of responses	Percentage
Online crowdfunding platform	18	46,15%
Friend forwarded link	4	10,26%
Facebook	9	23,08%
Newsletter of platform	3	7,69%
Other (email)	5	12,82%
TOTAL	39	100%

It is evident that, although the link was only made available in the newsletter of Jumpstarter, shared via correspondence of Thundafund and on Facebook by the researcher, people used social media and the Internet to further share information.

8.6 RESPONDENTS' KNOWLEDGE OF CROWDFUNDING MODELS

All 39 respondents (100%) indicated that they know what crowdfunding is. Different questions were asked to gain further insights into their knowledge.

8.6.1 Source of knowledge of crowdfunding

The knowledge of crowdfunding of the respondents was mainly (58,97%) gained from using the Internet and Facebook. The responses are indicated in Table 27.

Table 27: Source of knowledge of crowdfunding

Source	Number of responses	Percentage
Facebook	7	17,95%
Friend	6	15,38%
Internet	16	41,03%
Readings	5	12,82%
Other	5	12,82%
TOTAL	39	100%

From the table above, it is evident that the Internet is a valuable source of knowledge and is used by the respondents.

8.6.2 Familiarity with crowdfunding models

Respondents were required to indicate which crowdfunding models they were familiar with. The responses are indicated in Table 28. Most respondents (25 of the 39) were most familiar with the donation model.

Table 28: Crowdfunding models familiar with

Model	Number of responses	Percentage
All four models	3	7,69%
Debt	1	2,56%
Donation	25	64,11%
Reward	4	10,26%
Equity	1	2,56%
Debt and donation	1	2,56%
Donation and equity	2	5,14%
Donation, equity, reward	1	2,56%
Donation, reward	1	2,56%
TOTAL	39	100%

8.6.3 Participation in crowdfunding projects

Respondents were required to indicate if they had ever made contributions to a crowdfunded project. 48,72% (19 of the 39) indicated that they had contributed to a crowdfunded project. The responses are indicated in Table 29.

Table 29: Contributed to a crowdfunded project

	Number of responses	Percentage
Yes	19	48,72%
No	20	51,28%
TOTAL	39	100%

The respondents were furthermore required to indicate if they had ever created a crowdfunded project for which they required funding. 19 of the 39 (48,72%) respondents indicated that they had created a crowdfunded project. The responses are indicated in Table 30.

Table 30: Created a crowdfunded project to obtain funding

	Number of responses	Percentage
Yes	19	48,72%
No	20	51,28%
TOTAL	39	100%

To the question of whether or not they would make use of crowdfunding to obtain funding for a project, 84,62% indicated that they would. The responses are indicated in Table 31. This is an indication that crowdfunding can be used to stimulate the economy by granting funding to entrepreneurs (see section 2.4.2).

Table 31: Will make use of crowdfunding to obtain funding

	Number of responses	Percentage
Yes	33	84,62%
No	3	7,69%
I don't know	3	7,69%
TOTAL	39	100%

8.6.4 Purpose of crowdfunding

Respondents were required to indicate if crowdfunding is a viable means to obtain funding for small business, charitable causes or both. The majority indicated that crowdfunding is a viable means to obtain funding for charitable purposes. This is in agreement with the fact that most respondents indicated (as in Table 28 above) that they were most familiar with donation-based crowdfunding. The responses are indicated in Table 32.

Table 32: Purpose of crowdfunding

	Number of responses	Percentage
Small business	6	15,38%
Charitable	21	53,85%
Small business and charitable	11	28,21%
Other	1	2,56%
TOTAL	39	100%

8.6.5 Access to capital

The majority (66,67%) of respondents indicated that they thought that everybody should be provided an opportunity to invest in a business, regardless of their level of

knowledge about investments (financial literacy). The responses are indicated in Table 33.

Table 33: Should investment opportunities be available to everybody?

	Number of responses	Percentage
Yes	26	66,67%
No	8	20,51%
I don't know	5	12,82%
TOTAL	39	100%

Of the 26 respondents who indicated that investment opportunities should be available to everybody, 22 respondents provided a reason. The reasons provided were grouped together as follows:

- Nine respondents emphasised an open democracy as a reason in their response.
- Ten respondents were of the opinion that you learn by doing and will only learn financial literacy and business if you are given the opportunity to participate.
- Three argued that you should be allowed to invest if you have the financial means and the information and risks of the business are made clear.

One respondent commented that “Investing in a business should be more simplified for those less literate in the knowledge of investing. Investing is something that should be well known to the common person just like tax is.”

The six respondents who provided a reason as to why they answered “No” all argued that the risk of abuse is high if you have limited business knowledge.

A similar response was received when respondents were asked whether or not only registered banks should be allowed to provide funding to start-up businesses. The responses are indicated in Table 34.

Table 34: Should only banks provide funding?

	Number of responses	Percentage
Yes	9	23,08%
No	25	64,10%
I don't know	5	12,82%
TOTAL	39	100%

Respondents were asked if they thought that access to capital was easily obtainable for entrepreneurs. The majority (69,23%) indicated that it was not. The responses are indicated in Table 35.

Table 35: Ease of access to funds by entrepreneurs

	Number of responses	Percentage
Yes	4	10,26%
No	27	69,23%
I don't know	8	20,51%
TOTAL	39	100%

The main reasons provided by the respondents for the difficulty in accessing funding for entrepreneurs were the red tape involved, and the lack of collateral (security) on the part of the entrepreneur.

From the responses in the tables above, it is clear that access to funding is not easily obtainable by entrepreneurs in South Africa (also see section 2.4.1 in Chapter 2). Respondents were of the view that access to funding should be democratised, together with access to investment opportunities. Crowdfunding was seen as a valuable means of addressing this.

8.6.6 Risks associated with investment

Table 36 indicates the level of perceived risk associated with investing in a rewards-based crowdfunding project (an entrepreneurial business that offers you a product in return for the contribution received) of the participants:

Table 36: Likelihood of perceived risk of all respondents

Likelihood	Number of responses	Percentage
Very likely	7	17,95%
Likely	5	12,82%
Possible	21	53,85%
Very unlikely	5	12,82%
Unlikely	1	2,56%
TOTAL	39	100%

A similar result was obtained when analysing only the responses of those participants who had already participated in crowdfunding (either as a funder (19 respondents) or as a project owner (19 respondents)) of which 12 respondents fell into both categories, i.e., both funded and were project owners) as indicated in Table 37.

Table 37: Likelihood of risk of only those who had participated in a project

Likelihood	Number of responses	Percentage
Very likely	5	19,23%
Likely	4	15,38%
Possible	13	50,00%
Very unlikely	3	11,54%
Unlikely	1	3,85%
TOTAL	26	100%

Even though respondents were aware that there is a risk involved in crowdfunding, the majority (84,62%) of the 39 participants indicated that they would make use of crowdfunding to obtain funding as was indicated in Table 31 above. This therefore supports the argument that, even though respondents were aware of the risks associated with crowdfunding (also see section 2.5 of the literature review), crowdfunding is growing and will continue to grow in South Africa.

8.6.7 Knowledge of taxation

Respondents were required to rate their level of knowledge about the SA ITA. 58,97% of the respondents indicated that their knowledge of the SA ITA was novice to fundamental awareness. The responses are indicated in Table 38.

Table 38: Knowledge of SA ITA

Likelihood	Number of responses	Percentage
Fundamental awareness (basic knowledge)	11	28,21%
Novice (limited experience)	12	30,77%
Intermediate (practical application)	13	33,33%
Advanced (applied theory)	3	7,69%
Expert	0	0%
TOTAL	39	100%

The lack of knowledge of the ITA was furthermore evident from the question of whether or not the respondents were familiar with the income tax consequences of the funder as indicated in Table 39. Even though 41,02% of the respondents indicated in Table 38 that their knowledge of taxation was intermediate to advanced, 89,74% of the respondents indicated that they were not familiar with the income tax consequences of the funder for crowdfunding. This supports the finding from the literature that the income tax consequences are not certain.

Table 39: Familiarity of respondents with income tax consequences of the funder

	Number of responses	Percentage
Yes	4	10,26%
No	35	89,74%
TOTAL	39	100%

Respondents were required to indicate whether or not they thought that the current tax legislation in South Africa encouraged or discouraged crowdfunding. The responses are reflected in Table 40.

Table 40: Encouragement of tax legislation in support of crowdfunding

	Number of responses	Percentage
Encourages	6	15,38%
Discourages	11	28,21%
I don't know	22	56,41%
TOTAL	39	100%

Most respondents indicated, as seen in Table 40 above, that they did not know if the current SA tax legislation encouraged or discouraged crowdfunding. This response was expected based on the fact that they had indicated (see Table 38 and Table 39 above) that they were not familiar with the tax consequences of crowdfunding. However, 83% indicated that they thought that funding received through crowdfunding should not be taxed. This is indicated in Table 41, where respondents were required to indicate whether they thought that funding received through crowdfunding should be taxed. One respondent did not complete this question. The omission is, however, not significant to the study and will not have a material effect on the average for the question or the results of the other questions.

Table 41: Should crowdfunding be taxed?

	Number of responses	Percentage
Yes	6	15,79%
No	32	84,21%
TOTAL	38	100%

The lack of knowledge of the SA income tax consequences as well as the fact that 84,21% of the 38 respondents who answered the question indicated that they thought that crowdfunding should not be taxed and 84,62% (see Table 31) indicated that they would use crowdfunding to obtain funding, supports the notion that there may be a risk of possible tax evasion and tax avoidance, as identified with crowdfunding in section 2.5.7.

8.6.8 Effect of incentives

Respondents were asked whether, if they were to assume that they would receive a tax deduction/tax benefit for the amount contributed to a crowdfunding project, this would have an influence on their decision to contribute or not to contribute. Two respondents did not answer the question but the effect thereof is not material to the results. The responses are reflected in Table 42.

Table 42: Influence of a possible tax deduction for all respondents

	Number of responses	Percentage
Yes	14	37,84%
No	23	62,16%
TOTAL	37	100%

However, when asked about a random project, 71,05% of the (27 of the 38 participants who answered the question) respondents indicated that a tax deduction would encourage them to invest in a project, as indicated in Table 43. One respondent did not answer the question but the effect thereof is not material on the results.

Table 43: Effect of a tax deduction in relation to a random project

	Number of responses	Percentage
Yes	27	71,05%
No	11	28,95%
TOTAL	38	100%

Similar results were obtained when only those who had made contributions to crowdfunding projects (19 respondents of which one did not answer the question) were taken into account. The responses are indicated in Table 44.

Table 44: Effect of a tax deduction in relation to only those who contributed

	Number of responses	Percentage
Yes	7	38,89%
No	11	61,11%
TOTAL	18	100%

However, when asked about a random project, 63,64% (7 of the 11) of the respondents who had indicated that a tax deduction would not have influenced their decision to have invested, indicated that a tax deduction would encourage them to invest in a project. This is an indication that a tax incentive might encourage crowdfunding. The responses are indicated in Table 45.

Table 45: Effect of a tax deduction on a random project, related to only those who had previously contributed to a project

	Number of responses	Percentage
Yes	7	63,64%
No	4	36,36%
TOTAL	11	100%

Respondents were required to indicate if they had ever **invested** in a project. The question was intended to obtain an indication of those who had invested in businesses. 15 respondents indicated that they had. The researcher is, however, of the opinion that this question might have been misunderstood by respondents. This is because most (10 of the 15) indicated a charitable project whereas only three indicated an investment in a business (rewards-based) and two indicated both donation and rewards-based projects.

The 15 respondents who indicated that they had **invested** in a project in the past were then required to indicate why they had invested in a project. The responses are indicated in Table 46. The main reason for investing was identified as being out of pure generosity.

Table 46: Factors that encouraged respondents to invest (those who had invested)

Reason	Number of responses	Percentage
Pure generosity (i.e., to make a donation)	7	46,64%
The project is the project of a family member	1	6,67%
The project is the project of a friend	0	0%
To obtain a financial benefit from the project	0	0%
To obtain the product (reward) offered by the project	1	6,67%
To obtain the marketing benefit	1	6,67%
Project of a family member and to obtain the product (reward)	1	6,67%
Pure generosity and to obtain the product (reward) from the project	1	6,67%
Pure generosity, to obtain the product (reward) and a marketing benefit	1	6,67%
Pure generosity, project of a friend and to obtain the product (reward)	1	6,67%
Other	1	6,67%
TOTAL	15	100%

The 15 respondents who indicated that they had invested in a project, were furthermore asked to indicate what incentive(s) they expected to receive from the project that they had invested in. The responses are indicated in Table 47.

Table 47: Expected benefit (those who invested)

Expected benefit	Number of responses	Percentage
Financial benefit	1	6,67%
Intrinsic benefit	2	13,33%
Product	2	13,33%
Intrinsic and product	3	20,00%
None	7	46,67%
TOTAL	15	100%

60% of the 15 respondents furthermore indicated that they had received the expected benefit and 26,65% indicated that this was not applicable. Furthermore 14 of the 15 (93,33%) respondents indicated that they had not received a tax benefit from investing in the project.

The results from the table above support the results shown in Table 46 that the main reason for investing in a specific project was out of pure generosity and not to get a benefit.

The 19 respondents who indicated that they had **contributed** to a project in the past were required to indicate what would encourage them to invest in a project by ranking the options from 1 to 7 (1 being the main encouragement). The responses are reflected in Table 48. The table only indicates the responses for which a ranking of 1 was given. Some respondents ranked a particular option equal to another by giving a ranking of 1 to more than one option.

Table 48: Factors that would encourage participants to invest (those who had contributed)

Factor	Number of responses	Percentage
A tax benefit	1	5,26%
Pure generosity (i.e., to make a donation)	4	21,06%
The project is the project of a family member	3	15,80%
The project is the project of a friend	0	0,00%
To obtain a financial benefit from the project	1	5,26%
To obtain the product offered by the project	1	5,26%
A tax benefit and pure generosity	2	10,53%
To obtain a financial benefit and a product from the project	1	5,26%
Pure generosity (i.e., to make a donation), project of a family member and project of a friend	1	5,26%
Pure generosity (i.e., to make a donation), project of a family member and project of a friend and other	1	5,26%
Other	1	5,26%
No number 1 rating given to any factor	3	15,79%
TOTAL	19	100%

The above question was also asked of all respondents, regardless of whether or not they had contributed in the past. The results are reflected in Table 49.

Table 49: Factors that would encourage participants to invest

Factor	Number of responses	Percentage
A tax benefit	1	2,56%
Pure generosity (i.e., to make a donation)	9	23,09%
The project is the project of a family member	3	7,69%
The project is the project of a friend	0	0%
To obtain a financial benefit from the project	0	0%
To obtain the product offered by the project	2	5,13%
A tax benefit and pure generosity	4	10,27%
A tax benefit and project of family	1	2,56%
Pure generosity and project of a family member	1	2,56%
Pure generosity and to obtain the product	1	2,56%
Project of a family member and to obtain the financial benefit	2	5,13%
To obtain a financial benefit and a product from the project	2	5,13%
To obtain the tax benefit, financial benefit and the product	1	2,56%
To obtain the tax benefit, project of a family member, project of a friend	1	2,56%
Pure generosity (i.e., to make a donation), project of a family member and project of a friend	1	2,56%
Financial benefit, to obtain the product and other benefit (belief in project)	1	2,56%
Selected more than three as 1, ranking of which tax is one	3	7,69%
Selected more than three as 1, ranking of which tax is not one	1	2,56%
No number 1 rating	4	10,27%
No answer	1	2,56%
TOTAL	39	100%

Nine respondents indicated that they would make contributions purely out of generosity. However, 19 of the 39 respondents indicated that pure generosity is one of the factors (alone and together with other benefits) that would encourage them to invest in a project. Furthermore, 13 of the 37 (of which only three mentioned a project of family member alone, and none mentioned the project of a friend alone as a reason) indicated that if the project were the project of a family member and/or a friend, it would encourage them to invest. Only one of the respondents indicated that a tax benefit was the main factor that would encourage them to invest. However, 11 of the 39 respondents indicated that a tax benefit (alone and together with other benefits) would encourage them to invest in a project. It therefore follows that pure generosity is the main reason for contributing, followed by the project being that of family or friends and thirdly a tax benefit. 12 of the 39 respondents also indicated that a financial benefit or the product offered would encourage them (alone and together with other benefits).

As was determined in the review of the international literature in section 2.3, local funders (funders within 50km of the project creator) were more likely to invest in a specific project in contrast to other more distant funders, and were also most likely to invest in the early stages of a project (Agrawal, Catalini & Goldfarb, 2011:10,15-16,19). This was attributed to the fact that friends and family (who form part of the local funders) are more likely to invest in the early stages in comparison to unrelated funders, since they know the investor and the information asymmetry is therefore assumed to be minimal (Agrawal, Catalini & Goldfarb, 2011:16). However, distant funders' propensity to invest increased as the project creator accumulated capital. Their investment, in aggregate, accounted for the vast majority of the total investments received by the project creator (Agrawal, Catalini & Goldfarb, 2011:10,15). It was suggested that the early investments served as a signal of entrepreneurial commitment which would make it more likely for other funders to invest (Agrawal, Catalini & Goldfarb, 2011:20). It was concluded that funding is therefore not geographically constrained and is independent of geographic distance between the funder and project creator (Agrawal, Catalini & Goldfarb, 2011:19). The data displayed in Table 48 supports these arguments since it was indicated that, if the project were the project of a family member or a friend, it would

encourage the respondents to invest. However, based on the result, other benefits would also encourage them.

8.7 CONCLUSIONS FROM THE SURVEY INSTRUMENT

The purpose of the questionnaire was to get a further understanding (following the interviews) of the crowdfunding landscape from a South African viewpoint. The findings obtained from the interviews with the founders of platforms as well as the information obtained from the review of the international literature, were used to compile the questionnaire. It was then determined whether some of the findings could be supported by the responses from the questionnaire. This view from a South African viewpoint is important to determine, since Burtch, Ghose and Wattal (2013:3) argue that the behaviour of funders is an important aspect that must be considered in formulating policies and regulations relating to crowdfunding (see section 3.3.1).

The information gathered through the survey was compared with the findings obtained in the first phase of this study. The comparison was performed with regard to the crowdfunding model used, the behaviour of funders, the motivations for investing and using crowdfunding, and the benefits and risks associated with crowdfunding. These comparisons are important in order to determine if crowdfunding in South Africa is comparable to crowdfunding internationally. This is important since the literature studied is based on international crowdfunding platforms (due to the lack of studies from a South African viewpoint) and furthermore in order to make recommendations for SA to remain competitive in the global market. The summary of the comparison is listed in Table 50 below.

Table 50: Comparative summary: Different models of crowdfunding

DIFFERENT MODELS OF CROWDFUNDING		
Literature	Interviews	Survey instrument
Donation (see section 2.2.1)	Confirmed	Confirmed
Reward (see section 2.2.2)	Confirmed	Confirmed
Debt (see section 2.2.3)	N/a ¹⁶⁹	Confirmed
Equity (see section 2.2.4)	Confirmed	Confirmed

It was determined in Chapter 2 (see Table 4) that crowdfunding abroad is similar to crowdfunding in South Africa. This was furthermore confirmed by the interviews (in Chapter 7) in which reference was made by interviewees to the US-based platform, Kickstarter. The types of behaviour of funders, as determined in section 2.3 in Chapter 2, are compared in Table 51.

Table 51: Comparative summary: Behaviour of funders

BEHAVIOUR OF FUNDERS		
Literature	Interviews	Survey instrument
Distribution of investments in the projects are highly skewed.	N/a ¹⁷⁰	N/a
Friends and family (which form part of the local funders) are more likely to invest in early stages in	N/a	Confirmed

¹⁶⁹ The interviews were held with the founders of the main crowdfunding platforms, of which Patrick Schofield is referred to as the “father of crowdfunding” and is the founder of a donation, reward and equity crowdfunding platform. The platforms that he founded are mainly referred to when searching the Internet for SA crowdfunding platforms. A SA debt-based crowdfunding platform could not be identified by the researcher through an Internet search.

¹⁷⁰ Where “N/a” is indicated in this table, the behaviour was not explicitly tested or referred to in the interview and/or survey.

BEHAVIOUR OF FUNDERS		
Literature	Interviews	Survey instrument
comparison to unrelated funders.		
Distant funders' propensity to invest increased as the project creator accumulated capital.	N/a	N/a
Funding is not geographically constrained and is independent of geographic distance between the funder and project creator.	Confirmed	Confirmed
Depth of the project description, images and videos used in the project description, as well as the fact that the founder has previously backed other projects, influence the funding success of the project positively.	N/a	N/a
The chance of a project being funded successfully decreases as the funding goal increases.	N/a	N/a

Crowdfunding was defined in Chapter 1 (see section 1.2.1) as an open call to any member of the public. This crowdfunding is used in South Africa regardless of the

respondents' race, age, and place of residence, level of financial literacy or field of occupation. Based on the age of the respondents, it is mainly used by those belonging to Generations Y and Z. It was determined (based on the field of occupation and level of knowledge about investments indicated by the respondents) that crowdfunding is being used by people with intermediate to less knowledge of investment decision making. This confirmed that crowdfunding is indeed an open call to any member of the public.

It appears that those who contributed out of pure generosity would not have been influenced by the possibility of a tax incentive. However, a tax incentive would have encouraged them if it had been a random project. Pure generosity was the main reason for contributing, followed by the project being that of family or friends, and thirdly by the possibility of a tax benefit.

The comparative summary of the benefits of crowdfunding is provided in Table 52 below.

Table 52: Comparative summary: Reasons for using crowdfunding

REASONS FOR USING CROWDFUNDING		
Literature	Interviews	Survey instrument
Access to financing (see section 2.4.1)	Confirmed	Confirmed
Stimulate the economy (see section 2.4.2)	Confirmed	Confirmed
Market testing and validation of products or services (see section 2.4.3)	Confirmed	Confirmed
Brainstorming (see section 2.4.4)	N/a ¹⁷¹	N/a

¹⁷¹ Where "N/a" is indicated in this table, the benefit was not explicitly tested or referred to in the interview and/or survey.

REASONS FOR USING CROWDFUNDING		
Literature	Interviews	Survey instrument
Developing a potential pool of loyal clients early in the start-up process (see section 2.4.5)	Confirmed	Confirmed
Intrinsic motivations (see section 2.4.6)	Confirmed	Confirmed

It was determined that access to funding is restricted. From the responses, it is clear that access to funding is not easily obtainable by entrepreneurs. Access to funding should be democratised, together with access to investment opportunities. Crowdfunding is seen as a valuable means of addressing this. Crowdfunding will continue to exist regardless of the fact that people are aware of the risks associated with the practice.

The comparative summary of the risks associated with crowdfunding is provided in Table 53 below.

Table 53: Comparative summary: Risks of using crowdfunding

RISKS OF USING CROWDFUNDING		
Literature	Interviews	Survey instrument
Losses suffered by investors (see section 2.5.1)	Confirmed	Confirmed
Fraud (see section 2.5.2)	Confirmed	Confirmed
Failure to achieve production timetables and delivery promises (see	N/a ¹⁷²	N/a

¹⁷² Where “N/a” is indicated in this table, the risks were not explicitly tested or referred to in the interview and/or survey.

RISKS OF USING CROWDFUNDING		
Literature	Interviews	Survey instrument
section 2.5.3)		
Money laundering (see section 2.5.4)	Confirmed	N/a
Investor protection (see section 2.5.5)	Confirmed	Confirmed
Intellectual property protection (see section 2.5.6)	N/a	N/a
Tax evasion (see section 2.5.7)	Confirmed	Confirmed

Tax avoidance and/or tax evasion was identified as a risk in Chapter 2. It was also determined in Chapter 1 that there is a clear lack of knowledge and/or certainty regarding the tax consequences of crowdfunding. The respondents confirmed that there is a lack of knowledge of the tax consequences also in South Africa. This lack of knowledge, together with the indication that the majority of the respondents would make use of crowdfunding but did not think that crowdfunding should be taxed, increases the risk of tax evasion and/or tax avoidance. Furthermore, as was determined in Chapter 6, existing legislation is not easy to interpret. People already having a very limited knowledge of the tax laws and other regulations (as indicated in Chapter 6) might unintentionally find it even impossible to fully comply with legislation relating to crowdfunding.

This study is important as it contains the first empirical results relating to crowdfunding in South Africa. It therefore contributes to the body of knowledge of crowdfunding from a South African viewpoint. Information gathered through the literature review, interviews and the questionnaire was evaluated and compared. It was established that the crowdfunding landscape in South Africa displays similarities to the global crowdfunding landscape. It was important to establish this confirmation of similarities in order to consider principles from the practices applied globally, with reference to the

USA, UK, Australia and New Zealand in recommending a tax framework for crowdfunding in SA.

The last chapter will present the conclusions and recommendations for a distinct policy framework (proposed income tax law changes/implementation) for the South African crowdfunding industry that is not counterproductive, encourages SME growth and assists in keeping the industry competitive in the global market. Recommendations for further research will also be discussed.

CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS OF THE STUDY AND RECOMMENDATIONS FOR FURTHER RESEARCH

9.1 INTRODUCTION

This study has concluded that crowdfunding transactions, together with the benefits and risks of using crowdfunding in South Africa, are similar to those of crowdfunding abroad. It has furthermore concluded that, since there are no specifically designed tax provisions for crowdfunding transactions in South Africa, the tax implications of crowdfunding transactions are not always certain or do not support and promote crowdfunding. Currently the tax implications of such transactions fall within the general tax principles of the ITA. Current tax laws do not always provide clear-cut answers for all crowdfunding models as to whether or not some crowdfunding transactions are included or excluded from taxable income. Most of the existing tax principles were established before today's technological innovations and expansion through the use of the Internet.

Specific legislation or guidelines, explicitly for crowdfunding transactions, will make the taxation of crowdfunding more efficient, equitable and easier to administer (Battista, 2015:144). It is furthermore important that such legislation and guidelines should also support the government's goal of economic growth and job creation, as stated in the NDP (see Chapter 5). Tax provisions and guidelines should therefore not be too stringent or overregulating since this will hinder entrepreneurs and small businesses from accessing funds from willing funders. The recommendations from this study, as well as the proposal of a tax framework for crowdfunding in SA, are provided in this chapter.

9.2 PROBLEM STATEMENT, RESEARCH QUESTIONS AND RESEARCH OBJECTIVES

The main research objective (section 1.5.1) for this study was to critically evaluate the taxation of crowdfunding transactions in South Africa in order to recommend an appropriate tax framework (tax law adjustment/incorporation) for crowdfunding in South Africa. The fundamental research question was therefore to consider whether the current taxation provisions in South Africa are appropriate for the economic environment in the 21st century and – if not – what more optimal set of provisions might be adopted (section 1.5.1).

The main objective of this study was supported by the following secondary objectives (section 1.5.2) and related research questions addressed in the indicated chapters:

1. To explore crowdfunding (Chapter 2, Chapter 7 and Chapter 8).
 - a. What are the different crowdfunding models?
 - b. What are the reasons for and background to using crowdfunding?
2. To determine the tax implications of crowdfunding from an international perspective using the theoretical construct as underpin (Chapter 4).
 - a. What are the tax implications of the different crowdfunding models internationally?
3. To critically analyse the taxation of crowdfunding transactions from a South African perspective using the theoretical construct as underpin (Chapter 6).
 - a. What are the tax implications of the different crowdfunding models currently in South Africa?
4. To determine to what extent the current tax legislation dealing with crowdfunding transactions meet the objectives of the government of South Africa (Chapter 5 and Chapter 6).
 - a. How should South African tax policies be amended or drafted to ensure the effective and efficient taxation of crowdfunding transactions that is aligned with the objectives of the government of South Africa?

5. To provide a framework for the taxation of crowdfunding transactions for South Africa that can be used in the development of a tax framework for crowdfunding for South Africa (Chapter 9).
 - a. How should South African tax policies be amended or drafted to ensure the effective and efficient taxation of crowdfunding transactions that are aligned with the objectives of the government of South Africa?

9.3 A REVIEW OF THE RESEARCH RESULTS

9.3.1 Conclusions from Chapter 2

This research commenced with the first phase of the study which was performed by means of the collection and analysis of qualitative secondary data gained from scientific database analysis and library research. This included a study of appropriate sources containing authoritative publications, books, journals, the Internet and official documents such as policies to gather information on the various crowdfunding models. This established a global theoretical platform for the study. In this phase, crowdfunding, as well as the different models of crowdfunding, were explained and defined. The body of available literature on crowdfunding consists mainly of studies performed internationally since no significant study from a South African viewpoint could be identified.

The characteristics of crowdfunding were discussed in Chapter 2. Crowdfunding is an open call to any member of the public, and includes both sophisticated and unsophisticated investors. Crowdfunding is therefore a means of democratising access to investments and funding. This was determined from the literature studied (see sections 1.1 and 2.4.2) and was confirmed through the interviews conducted (see section 7.2.1) as well as through the results of the questionnaire (see section 8.6.5).

It was furthermore determined that, in addition to intrinsic motivations, crowdfunding is also used for market testing and product validation, for brainstorming ideas and to develop a potential pool of loyal clients. The risks involved in crowdfunding include

financial losses due to failure of projects, fraud, failure to achieve production timetables, money laundering, intellectual property rights infringement, and tax evasion.

9.3.2 Conclusions from Chapter 3

The research philosophy and research design were described in Chapter 3. It was determined that the worldview of pragmatism is focused on what works in practice and on the consequence of the research rather than on the methods used. This study is grounded in the pragmatic philosophical paradigm.

Due to the limited available research on crowdfunding from a South African perspective, an exploratory mixed method research approach was followed in this study. This design was deemed to be appropriate due to the limited available research on crowdfunding from a South African perspective.

In this exploratory sequential design study, a combination of qualitative and quantitative research data was used. Both play an important role in addressing the research problem. However, since the main objective of the study was to critically evaluate the taxation of crowdfunding transactions in SA in order to recommend an appropriate tax legislation amendment, the qualitative phase (consisting of a literature review as well as information gathered through interviews (see Chapters 2, 4, 5, 6 and 7)) of the research design was the first phase of the research.

The first phase is followed by the second, quantitative, phase, guided by the findings of the first phase. Data was collected by means of a questionnaire (see Chapter 8 and Annexure A) to determine the relevance of the findings of the first phase to a broader sample in a South African context.

9.3.3 Conclusions from Chapter 4

Crowdfunding is growing, as was observed from the increasing statistics in the platform data. It is evident from Chapter 4 and Chapter 6 that South Africa is lagging behind

when it comes to crowdfunding regulation and tax incentives. In contrast with South Africa, the USA, UK, Australia and New Zealand all have some kind of regulations/discussion papers, or specific legislation referring to crowdfunding. The UK and Australia also have tax incentives to encourage crowdfunding.

9.3.4 Conclusions from Chapter 5

The South African government aims to decrease unemployment by encouraging small business creation and growth. Since funding is one of the main constraints of small businesses, crowdfunding is an alternative funding source for small businesses.

It is important that, in designing or evaluating tax legislation for crowdfunding transactions in South Africa, the aims and policy objectives, namely to reduce the regulatory burden for small businesses and to stimulate private investment by ensuring policy certainty of the government, are supported. It is furthermore important that the principles of a good tax system of efficiency, equity, simplicity, transparency, certainty and tax buoyancy be complied with in designing specific tax legislation for crowdfunding transactions.

Since crowdfunding is an international phenomenon that extends over continents because of the use of the Internet, the recommendations of the Mirrlees Commission and the OECD should also be considered in designing tax legislation for crowdfunding transactions. Bias in the tax treatment in favour of debt over equity finance or in favour of one entity/person above another should be avoided as far as possible to avoid distortion of economic activity.

9.3.5 Conclusions from Chapter 6

Crowdfunding combines traditional means in a unique form and therefore numerous pieces of legislation can apply, some of which were discussed in Chapter 6. The wording and application of the legislation are not always clear. Funders and project creators are not necessarily sophisticated investors and need protection; they might not

comply without even being aware of it or might incur a lot of costs just to comply. This might be misused by other, more knowledgeable, parties charging high administration fees. All of these lead to less funding for the start-up, which would defeat the purpose of the crowdfunding. Tax legislation does not treat all transactions equally. Deductions are provided for investments through a VCC, for example, but not through a small business funding entity. Furthermore, the SA tax legislation does not promote investing for funders directly in a project owner. This is because the available incentives of small business funding entities, VCCs and PBOs only apply if the investing is done through one of these vehicles as the middle-man. This contradicts the essence, characteristics and benefits of crowdfunding, which is to provide for a funder to invest directly in a crowdfunding project (see Chapter 2).

9.3.6 Summary of the results of the interviews in Chapter 7

A qualitative research approach, however, does not consist only of documentary sources but also of perspectives and beliefs of other role-players (Joubert, Hartell & Lombard, 2016:110). Interviews were conducted with relevant role-players of crowdfunding transactions to gain insight into the crowdfunding industry from a South African viewpoint (see Annexure A). The interviews were conducted with the founders of four of the main South African crowdfunding platforms to determine their experiences with crowdfunding and their reasons for making use of crowdfunding.

In addressing research question 1 (section 1.6), it was determined that Jumpstarter and Thundafund support donation and rewards-based crowdfunding, BackaBuddy supports donation-based crowdfunding and Uprise.Africa is South Africa's first equity crowdfunding platform. It was also determined that these crowdfunding models are similar to those used internationally.

In addressing research question 2 (section 1.6) it was determined that the main reason why project owners use crowdfunding, is to obtain funding. For the funders, an incentive with rewards-based crowdfunding encourages them to contribute. Social

recognition (intrinsic benefit) is also one of the main reasons why people contribute to a project.

In addressing research question 4 (section 1.6), it was determined that the founders are aware of the basic tax implications but are not sure about these, and do not have a thorough knowledge of taxation, not being tax specialists. Jumpstarter and BackaBuddy are exempt from tax due to their non-profit status. Jumpstarter supports rewards-based crowdfunding, while BackaBuddy is a donation-based crowdfunding platform. The reason provided for Jumpstarter's NPC status, is that it entitled the platform to other global benefits, including less regulatory compliance. BackaBuddy is registered as an NPC because it supports the purpose of the platform, being a donation-based platform for charitable causes. There is therefore clearly an inconsistency for applying and obtaining NPC status.

From the results of the interviews as well as a comparison thereof with the literature reviewed in Chapter 2, it is evident that crowdfunding in South Africa is similar to crowdfunding internationally. These results were furthermore confirmed by the results of the survey instrument used in Chapter 8 which is discussed below.

9.3.7 Summary of the empirical results in Chapter 8

The second phase of the research design was quantitative of nature and intended to determine the relevance of the findings of the first phase to a broader sample in a South African context. The findings obtained from the first phase of the study (the literature study and the interviews with the founders of the platforms) were used to develop a survey instrument (a questionnaire) which was sent to a population of funders and project creators. The purpose of the questionnaire was to gain a further understanding (following the interviews) of the crowdfunding landscape from a South African viewpoint. The findings obtained from the interviews with the founders of platforms as well as the information obtained from the review of the international literature, were used to compile the questionnaire. It was then determined whether or not some of the findings could be supported by the responses from the questionnaire. It was important to determine the

South African viewpoint as Burtch, Ghose and Wattal (2013:3) argue that the behaviour of funders is an important aspect that must be considered in formulating policies and regulations relating to crowdfunding (see section 3.3.1).

The information gathered through the survey was compared with the findings obtained in the first phase of this study. The comparison was performed with regard to the crowdfunding model used, the behaviour of funders, the motivations for investing and using crowdfunding and also the benefits and risks associated with crowdfunding. These comparisons are important in order to determine if crowdfunding in South Africa is comparable to crowdfunding internationally. This is important since the literature studied was based on international crowdfunding platforms (due to the lack of studies from a SA viewpoint) and furthermore in order to make recommendations for South Africa to remain competitive in the global market.

Information gathered from the literature review, the interviews and the questionnaires was evaluated and compared. It was established that the crowdfunding landscape in South Africa displayed similarities to the global crowdfunding landscape. This confirmation of similarities was important to establish in order to consider principles from the practices applied globally, with reference to the USA, UK, Australia and New Zealand, in recommending a tax framework for crowdfunding in SA. This study is important as it contains the first empirical results relating to crowdfunding in South Africa. It therefore contributes to the body of knowledge of crowdfunding from a South African viewpoint.

9.4 A TAX FRAMEWORK FOR CROWDFUNDING IN SOUTH AFRICA

Crowdfunding is still in its infancy in South Africa. Crowdfunding allows investors with unused capital to connect with entrepreneurs who need it, through the use of the Internet. Based on the qualitative as well as the empirical results, it is clear that crowdfunding is not a cure-all solution for all of the financing issues of small business. Crowdfunding does however open investment opportunities for new sources of capital

especially where access to funding is limited because of the lack of collateral of start-up businesses.

Leaving crowdfunding unregulated imposes risks to the investors as well as to the regulators. The recommendations from this study as well as a proposed tax framework for crowdfunding in SA are provided below.

9.4.1 Define crowdfunding

It is important that crowdfunding be defined in order to avoid misinterpretation and misuse of the term. It is proposed that the following definition of crowdfunding, as was defined for purposes of this study, be accepted:

Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in form of donation or in exchange for the future product or for some form of reward to support initiatives for specific purposes.” (Belleflamme, Lambert & Schvienbacher, 2014:588)

As was discussed in section 5.2, the Davis Tax Committee was instructed to determine whether the tax policy supports the government’s objectives of inclusive growth, employment, development and fiscal sustainability (Gordhan, 2013:21). It is therefore important that, in designing a tax framework for crowdfunding transactions in South Africa, the framework meets and supports the objectives and policy goals of the government. It was determined that crowdfunding supports the objectives and policy goals of the government of inclusive growth, reduction of inequality, employment and development (see Chapter 5).

Crowdfunding is an open call to any member of the public. The essence of crowdfunding is that it is an inclusive system and an open call to any investor and/or project owner, which should be protected at all stages especially in the South African context (also keeping in mind the history of South Africa pertaining to apartheid). The

regulatory requirements and income tax provisions should therefore support the characteristics and benefits of crowdfunding.

9.4.2 Regulate crowdfunding

Numerous researchers have emphasised the necessity for crowdfunding regulation to strike a balance between investor protection and capital formation (Heminway & Hoffman, 2011:962; Bradford, 2012:8). Overregulation could be costly to start-ups and should be prevented as far as possible since access to funding is already an obstacle for small businesses.

There is a trade-off between efficiency and inclusivity in the regulation of crowdfunding. Regulation is necessary to protect investors as well as to avoid erosion of the tax base, and certain disclosure requirements and responsibilities should be enforced on the platform. However, too stringent regulation in the form of investment caps and costly reporting requirements might impact inclusivity negatively. It was found that crowdfunding in New Zealand is more successful than in the USA (see section 4.4.4.1). This is because New Zealand supports efficiency through the following: more stringent gatekeeper responsibilities on platforms, no cap on the investment amount that an individual investor can invest, and allowing direct advertising without limitation. Also, the reputation of entrepreneurs (project owners) plays a bigger role in New Zealand than in the USA since New Zealand is a smaller country. Striking a balance between efficiency and inclusivity in regulating crowdfunding is required.

As South Africa, the UK and Australia are more comparable with New Zealand than with the USA in terms of size, it is proposed that platforms should have greater gatekeeper responsibilities (see section 9.4.2.1), and that direct advertising be allowed. It is however, proposed for South Africa, that caps should be placed on the investment amount that an individual investor can make. These caps are proposed to ensure the democratising of investment opportunities, to support inclusive growth, and to give unsophisticated investors an equal opportunity with that of sophisticated investors. This will furthermore serve as a mechanism to minimise financial loss to individual investors.

Legislation and regulation of crowdfunding are necessary in South Africa in order to ensure inclusivity, especially for unsophisticated investors. Such legislation should only include traditional crowdfunding and should prohibit complex and hybrid structures. It should eliminate the creation of monopolies by middle-men and opportunists, who make use of existing businesses and business structures, thus contravening and hijacking the essence of crowdfunding. Enforcing simple structures will limit compliance costs, tax evasion and tax avoidance. It will ensure transparency for all parties to a crowdfunding transaction, namely the funders, creators and regulators.

It was found in Chapter 6 that current legislation applicable to a crowdfunding transaction is not always clear or easy to interpret. Since various persons with different levels of education are (and should be) allowed to participate in crowdfunding, regulations and legislation should be of such a nature to be understandable and clear for any person to interpret. Although the main focus of this study is on taxation implications, limited attention has also been given to other regulatory matters such as the provisions of the Companies Act. Since it was found that a platform like Uprise.Africa had to incorporate complex company group structures in order to accommodate equity crowdfunding (see Chapter 7), it is proposed that clear provision should specifically be made in the Companies Act to support equity crowdfunding for private companies. This should be done without burdensome disclosure and compliance costs for such small companies.

It is furthermore proposed that all regulations and legislation applicable to crowdfunding be summarised and linked in one single regulatory document for crowdfunding. This will make the interpretation easier for both sophisticated and unsophisticated investors, and will aid in the democratisation of access to capital and investment opportunities in South Africa.

9.4.2.1 Platform responsibility and liability

It was found from the study of the literature, as well as from the interviews conducted with crowdfunding platform owners, that the function, types of income and expenses of

the various platforms are in essence the same, regardless of the crowdfunding model used. It was furthermore determined that platforms are not banks according to legislation, and merely hold the money in an escrow account. For these reasons, together with the fact that the main reason for using crowdfunding is to obtain money, all platforms should be treated the same and should not have a profit motive.

The registration requirements should, however, not be complex and expensive since the ultimate aim of crowdfunding is to maximise the funding ultimately available for the project owner. This can be obtained by making use of the existing provisions dealing with the registration of a PBO (which are currently similar to the registration requirements of a SBFÉ). This is discussed in section 9.4.5.

The gatekeeper functions are increased with the increase in complexity of the crowdfunding model. Therefore the gatekeeper function is more extensive in equity crowdfunding. However, the essence of the functions performed by the platforms of the various crowdfunding models remains the same. There should be a restriction on the percentage of fees that a platform is eligible to charge. This is because the percentage charged in fees ultimately reduces the contributions that are available for use by the project owner.

It is proposed that all platforms should perform gatekeeper functions and should validate project creators. Platforms that support crowdfunding should register as crowdfunding platforms. In order to retain independence, platforms or persons connected with the platform should not be allowed to invest in projects listed on the platform.

Access to the information on the platform should be open to the general public. Funders should be allowed to communicate freely and openly on the platform in order for other funders to make use of the “wisdom of the crowd”. Platforms should be allowed to remove irrelevant and fraudulent material after consultation and verification of the project owners. This is because it has been found that social media plays an important role in validating project owners. Being independent, the platform plays an

important part in the social vetting of a project and in ensuring that funders can communicate freely and share information on a platform, independently of the project owner. This will limit opportunities for fraud and will lead to better informed funders.

Crowdfunding not done through the platforms registered as PBOs will therefore be subject to normal tax rules as discussed in Chapter 6, and will not qualify for the proposed incentives (see section 9.4.5). This is because placing a registration requirement on platforms mitigates the risk of fraudulent platforms and consequent financial losses to funders. Platforms should have the responsibility of disclosure and reporting to funders and external parties (such as SARS). Crowdfunding might be misused for fraud and tax evasion if it is not regulated. By enforcing legislation requiring the platforms to provide SARS with information, the tax base is broadened and tax evasion is limited.

9.4.2.2 Project creator

It is proposed that crowdfunding legislation for reward, debt and equity-based crowdfunding in support of small businesses, should be aligned with the existing requirements of a small business, as set out in section 12E of the ITA. Aligning crowdfunding legislation with existing provisions promulgated for growth in the small business industry, will aid in respect to simplicity in interpreting legislation as well as efficiency in regulating crowdfunding. It is therefore proposed that:

- the small business (project creator) should be registered as a private company in order to be eligible for crowdfunding. This is regardless of the crowdfunding model used and is a requirement for the project creator and funder to qualify for the tax incentives (as discussed below). Requiring registration is an additional regulatory tool to ensure that only legitimate companies are created. Registration with the Companies and Intellectual Commission (CIPC) will provide an additional paper trail and compliance monitoring mechanism;
- for purposes of section 12E, it is proposed that the restriction on the shareholding of natural persons be simplified. Shareholding in other private companies should be allowed, limited to not more than 30% in each of such other private

companies. This will enable entrepreneurs to proceed with entrepreneurial activities and thereby stimulate economic growth; and

- the private company should be required to employ at least two full-time, unconnected employees engaged in the full-time business of the company. This should encourage job creation and thereby support the policy aims of the government.

Project creators should be required to disclose certain information to funders in order to enable them to make an informed decision on whether to invest or not. A limit should be placed on the total cumulative amount that can be raised by a project creator through all types of crowdfunding, including through VCCs, similar to the approach followed in the UK.

9.4.2.3 Funders

It is proposed that the tax incentives applicable to crowdfunding should only be allowed to funders if this is done through a registered, regulated platform (see section 9.4.2.1). Funders should be free to withdraw commitment at any time before the funding goal is met. It is proposed that a limit should be placed on the maximum amount that a single investor can invest in a crowdfunding project. This supports inclusivity and will aid in democratising investment opportunities.

9.4.3 Tax guidance on what constitutes a donation

A donation is defined in section 55(1) of the ITA as “any gratuitous disposal of property, including any gratuitous waiver or renunciation of a right”. Tax guidance is needed on what is regarded as a donation of a capital nature. Based on guidelines from principles of case law referred to, the following guidelines are proposed:

- The donor’s characterisation of his action is not determinative – that there must be an objective inquiry as to whether what is called a gift amounts to this in reality (*Bogardus v. Commissioner, 302 US 40*).

- The motives of the donor do not determine whether a gratuitous payment is income in the hands of the recipient. The character of the receipt in the hands of the recipient needs to be determined.
- It is not a trading receipt if the gift was wholly unexpected and unsolicited (*Simpson v Reynolds & Co (Insurances) Ltd 1975 and Walker v Carnaby, Harrower, Barham & Pykett 1970*).
 - It follows therefore that, if a product or service was received in return for the contribution, it is likely that the contribution is not a donation of a capital nature for the project owner, but a receipt of a revenue nature. It is not a gift if the payment proceeds are primarily from the “incentive of an anticipated benefit” of an economic nature (*Bogardus v Commissioner, 302 US 41*).
 - Furthermore, if a business receives contributions which are used to supplement its trading revenue or to enable the recipient to continue trade, the receipt is likely to be not of a capital nature but taxable (*CIR v Falkirk Ice Rink Ltd [1975] STC 434*).
 - If the contribution was made out of a moral or legal duty, it is not a capital receipt but a receipt of a revenue nature (*Bogardus v Commissioner, 302 US 34*). This is because it was not made out of detached and disinterested generosity, out of affection, respect, admiration, charity or like impulses (*Commissioner v LoBue, 351 US 243, 246; Robertson v United States, 343 US 714*). If there is a nexus between the gift and the taxpayer’s activities, it will be income if the gift is in a relevant sense a product of the activities.

DETERMINATION OF THE CROWDFUNDING MODEL FOR INCOME TAX PURPOSES

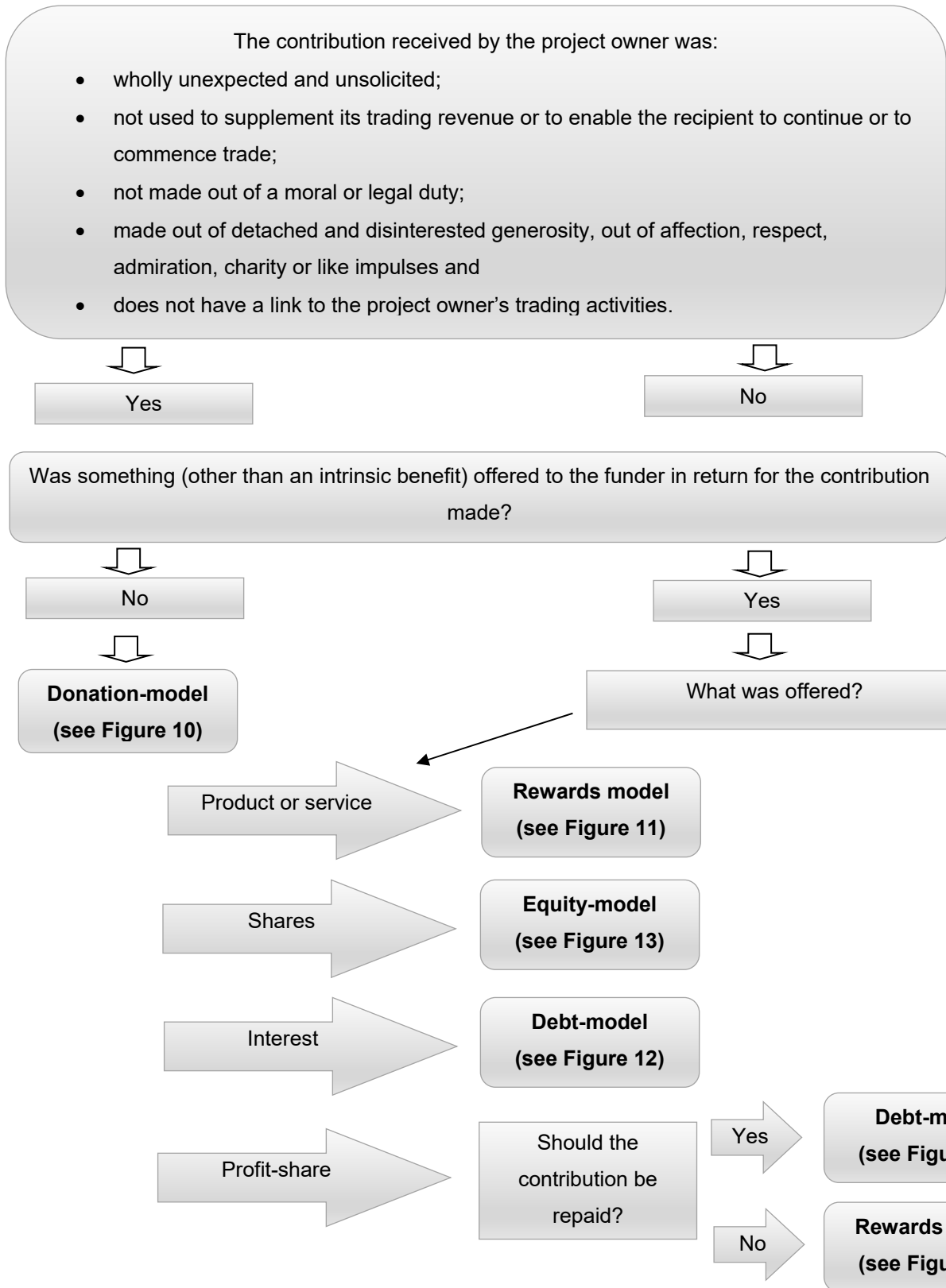


Figure 9: Determination of the crowdfunding model for Income Tax purposes (Own construct)

9.4.4 Tax guidance on what constitutes a trade

It was determined that crowdfunding is also used to fund start-up businesses. Tax deductions can only be claimed if a trade is being carried on. Tax guidance is needed on what a “trade” is, and when a trade commences for crowdfunding. The principles of what constitutes a trade when crowdfunding is used, however, do not differ from the normal principles currently applied.

9.4.5 Specific tax incentives

Growth of the small business sector is emphasised in various policy documents of the South African government, such as the NDP (see section 5.2). It is also recognised in documents of SARS, such as the External Guide to Venture Capital Companies (see section 6.2.3). All of these documents admit that access to finance is one of the main constraints to the growth of the small and medium business sector and should be improved.

As is evident from this study, crowdfunding is growing and is a valuable means of access to funding for small businesses. However, the ITA only makes provision (to a certain extent) for a deduction of equity funding through a VCC. There is therefore no fairness in treating one type of crowdfunding more favourably than another, taking into consideration the policy objective of the government and the lack of growth of the small business sector. Since access to funding is one of the main constraints and the government seeks to enhance the growth of the small business sector, all sources of funding should have similar tax incentives. This is also in alignment with the principles of equity and fairness of a good tax system, as was discussed in Chapter 5.

According to the DTC, the provisions of section 12J of the ITA are ineffective (Davis Tax Committee, 2014:22). This determination was based on the fact that, since the introduction of the provision in 2009 to the date of the report in 2014, only three VCCs were registered under section 12J (Davis Tax Committee, 2014:22). After some legislative changes in 2014, the number of registered VCCs had increased to 24 by

December 2015 (Davis Tax Committee, 2016b:36). According to the DTC, the provisions are primarily targeted at established SMEs and do not encourage the growth of micro businesses in SA (Davis Tax Committee, 2016b:36).

The Mirrlees Commission recommended that targeted tax measures should be used for small businesses instead of lower tax rates for all profits of all small businesses (see section 5.5) (Mirrlees *et al.*, 2011:469). This will limit the need for anti-avoidance provisions to prevent small companies from being established merely to take advantage of a reduced tax rate (Mirrlees *et al.*, 2011:463). A similar recommendation was made by the DTC with reference to the VCC provisions: it was recommended that National Treasury should consider the implications of the creation of a separate tax incentive to encourage angel investors in SMEs (Davis Tax Committee, 2016b:36). The recommendations from this study, pertaining to specific tax incentives, are discussed below.

Donation-based crowdfunding

The current provisions dealing with PBOs should be utilised to accommodate donation-based crowdfunding. Donation-based crowdfunding referred to here are those donations that are made out of pure generosity for charitable causes and that adhere to the principles referred to in section 9.2.6. It is therefore proposed that all platforms dealing with donation-based crowdfunding should register as PBOs. Such platforms will have to adhere to all registration requirements and perform gatekeeper functions to ensure that only legitimate projects of a benevolent nature (as listed in the Ninth Schedule of the ITA) are created on the platform. Funders should be allowed to donate to a specific project and not in general in order to maintain the characteristics of crowdfunding.

It was found from the literature and empirical results that the behaviour of the funders (to make a donation for a charitable project as a result of intrinsic motivation only) would not have been influenced, had there been a tax incentive. It is therefore recommended that the current list of public benefit activities, as contained in both Part I and Part II of

the Ninth Schedule of the ITA, should not be expanded at this stage to allow all giving of a charitable nature to crowdfunding to be made through a registered PBO platform.

It is, however, proposed that a tax credit should be introduced to provide for donations made to support small businesses (see rewards-based crowdfunding below for a discussion of the proposed small business funded (SBF) entity tax credit). This credit should only be provided if the donation has been made to a non-connected party. This will encourage social investment and wealth distribution to non-connected parties, given the results of the survey indicating that donations to family and friends are one of the main reasons for making donations. It will also minimise abuse between connected parties and will align the restrictions on connected parties with the provisions of the other crowdfunding models (as discussed below). These proposals are presented in the framework below outlined in Figure 10.

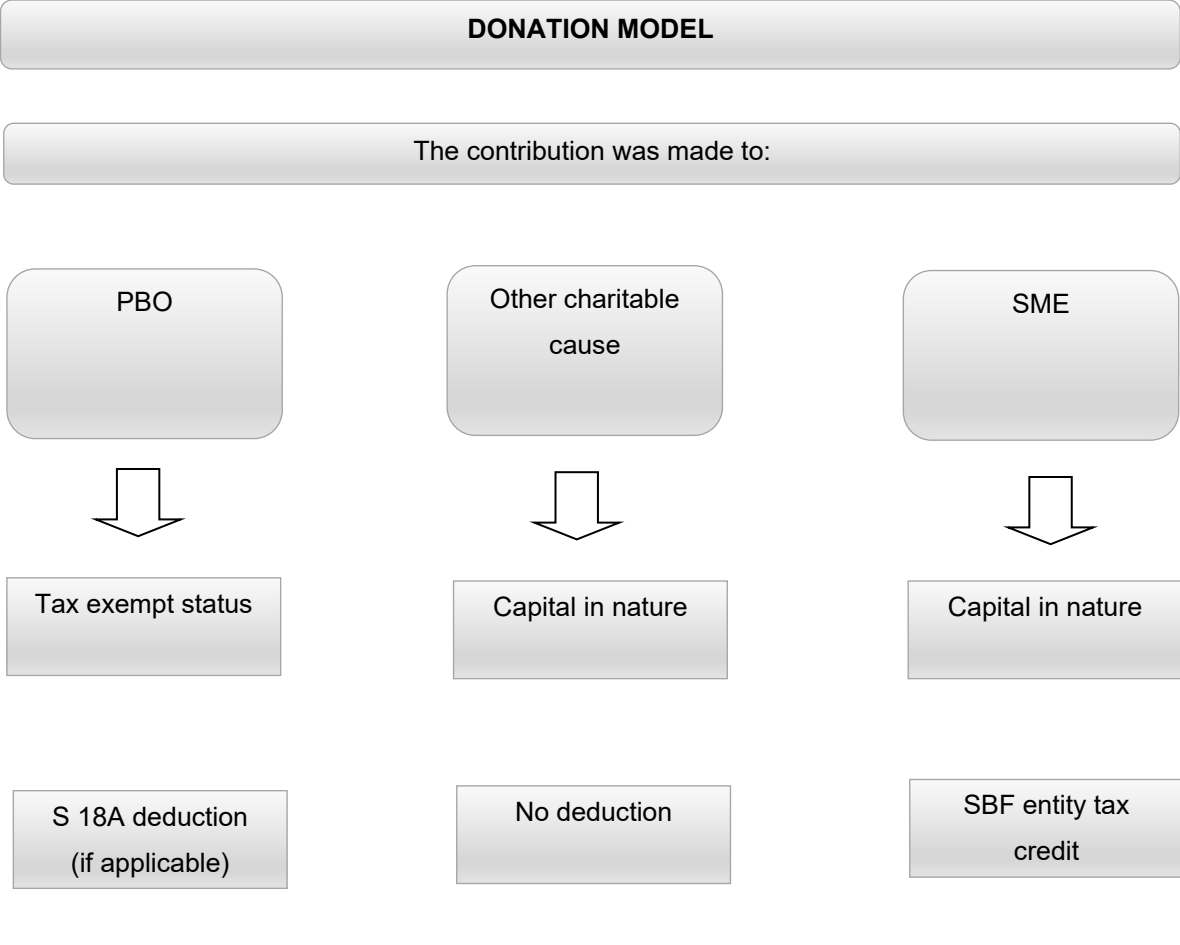


Figure 10: Donation model income tax implications (Own construct)

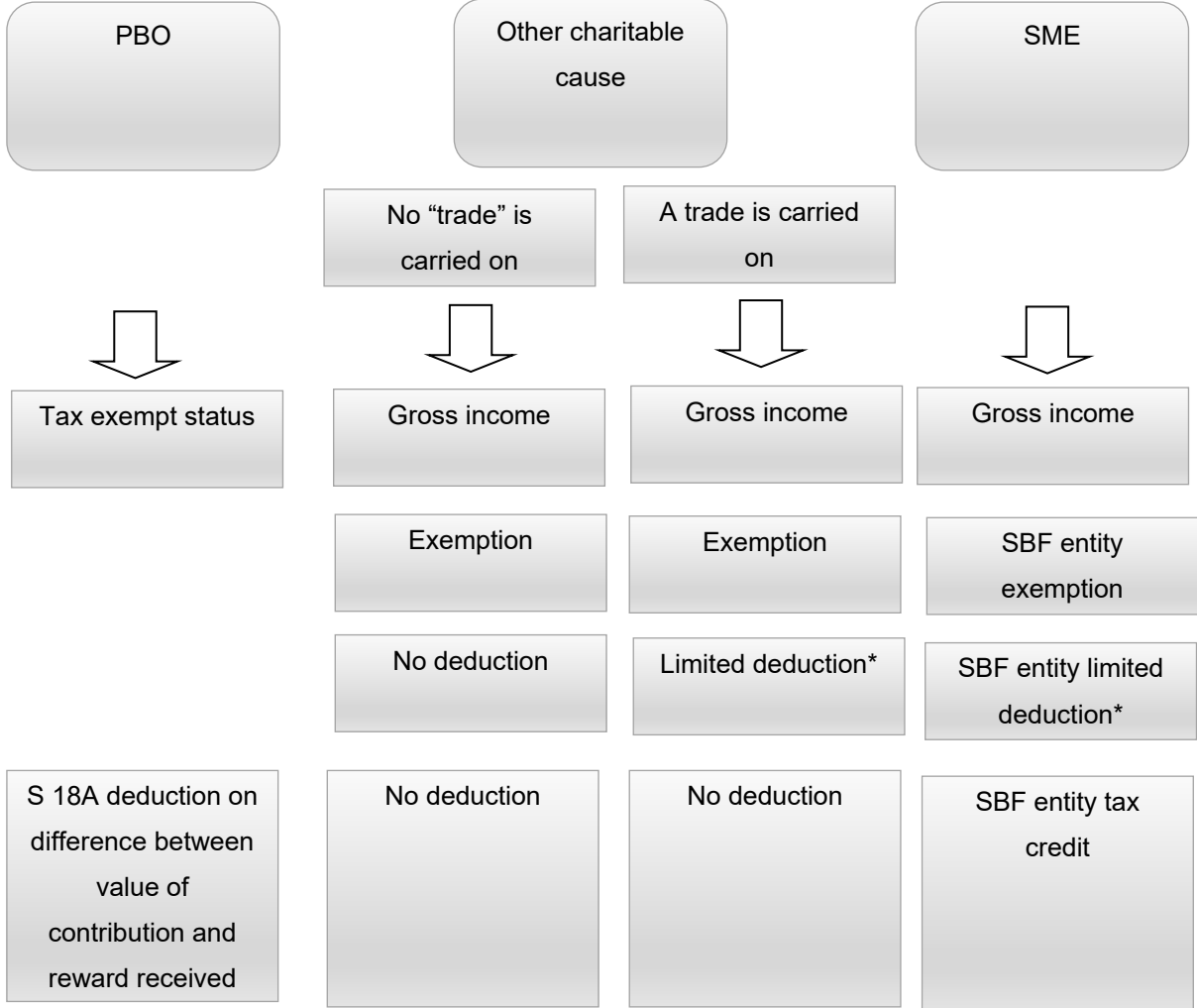
Rewards-based crowdfunding

The current provisions dealing with small business funding entities should be utilised to support all rewards-based crowdfunding in support of small businesses. It is proposed that provision should be made for businesses that have received funding to support their businesses through crowdfunding (and not through an SBFE), to register as small business funded (SBF) entities. The funding so received through crowdfunding should be exempt from tax in the hands of the SBF entity in a similar way that the current SBFE exemption exempts the funding received from an SBFE.

It is furthermore proposed that the approach followed in the UK regarding their EIS and SEIS, and in Australia regarding their ESIC, as discussed in section 4.4.2, be considered in the South African context. Based on principles followed in the UK and Australia, it is proposed that a single tax credit provision be introduced for the funders making contributions to such registered SBF entities. This credit should be based on the difference between the funding provided and the reward received (if any) in return. This will furthermore ensure that all funders are treated equally and that not only persons trading and making social investment contributions or enterprise development contributions qualify for a deduction under section 11(a). The UK allows a credit equal to 50% for SEIS investments which is decreased to 30% for EIS, decreasing the percentage to 30% for subsequent investments to an EIS or VCC investment. Australia in turn only has a single tax credit of 20%. A single tax credit will simplify the interpretation of the ITA, taking cognisance of the various demographics of the population of SA as well as the fact that crowdfunding is still in its infancy in SA. It is proposed that credit should be 30% of the investment amount (30% of the difference between the funding provided and the reward received (if any) in return).

REWARDS MODEL

The contribution was made to:



* The deduction should only be allowed for tax deductible expenditure incurred to the extent that the funding was not used to fund such expenses.

Figure 11: Rewards model income tax implications (Own construct)

Debt-based crowdfunding

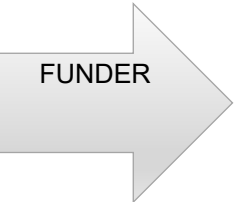
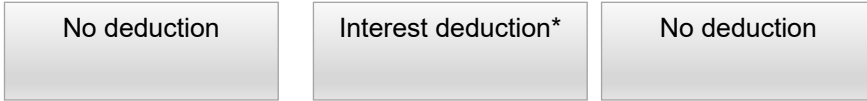
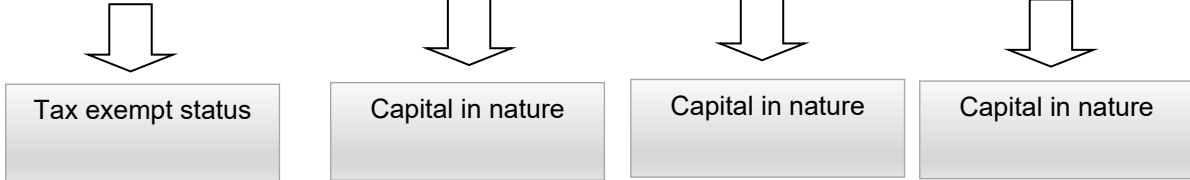
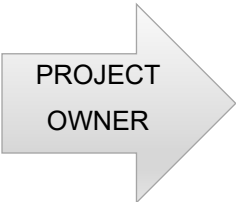
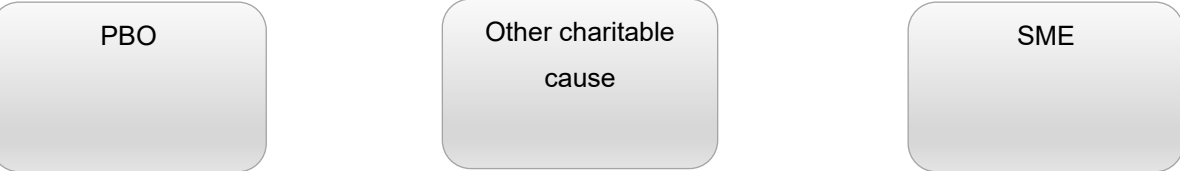
It is proposed that the provisions discussed above for SBF entities, also apply to funding received through debt-based crowdfunding. Provision should be made for businesses that received loans to support their undertakings through crowdfunding (and not through an SBFE), to register as SBF entities. The funding so received through crowdfunding should be capital in nature in the hands of the SBF entity. The SBF entity will then be entitled to an interest deduction for interest actually paid on such loan amount. The deduction should, however, only be based on the part of the loan used for trade purposes.

The funder will be entitled to the proposed SBF entity tax credit. The proposed SBF entity tax credit should be based on the difference between the interest earned and the interest that would have been, had the official rate of interest been charged. It is proposed that credit should be 30% of this amount. This is in agreement with the recommendation of the Mirrlees Commission as was discussed in section 5.5. The Commission recommends that a deduction should be allowed each year for the opportunity cost of capital previously saved or invested (Mirrlees *et al.*, 2011:475).

By using one provision for rewards-based, debt-based and equity-based crowdfunding, the ITA is simplified. Furthermore, having one provision and set of requirements for those types of crowdfunding provided to small businesses will ensure transparency, certainty, equity and fairness.

DEBT MODEL

The contribution was made to:



* The deduction should only be allowed for the interest incurred on the loan to the extent that the loan was used for trade purposes.

Figure 12: Debt model income tax implications (Own construct)

Equity-based crowdfunding

The proposed SBF entity tax credit should also apply to equity crowdfunding. It is, however, also proposed that the proposed SBF entity tax credit and the current section 12J should be applied cumulatively. As was seen in Chapter 4 in the UK and Australia, caps are placed on the amounts invested. Section 12J already allows for that, with R5 million for a company and R2.5 million for a person other than a company (which will be the natural person funder). It is proposed that this restriction be further detailed to distinguish between sophisticated and non-sophisticated/retail investors, allowing a lesser amount for investors who are not sophisticated investors.

Deferred capital gains tax consequences are proposed where the proceeds from the disposal of shares purchased in an SBF entity are used to buy shares in another SBF entity. This will furthermore encourage continuous investments in upcoming businesses.

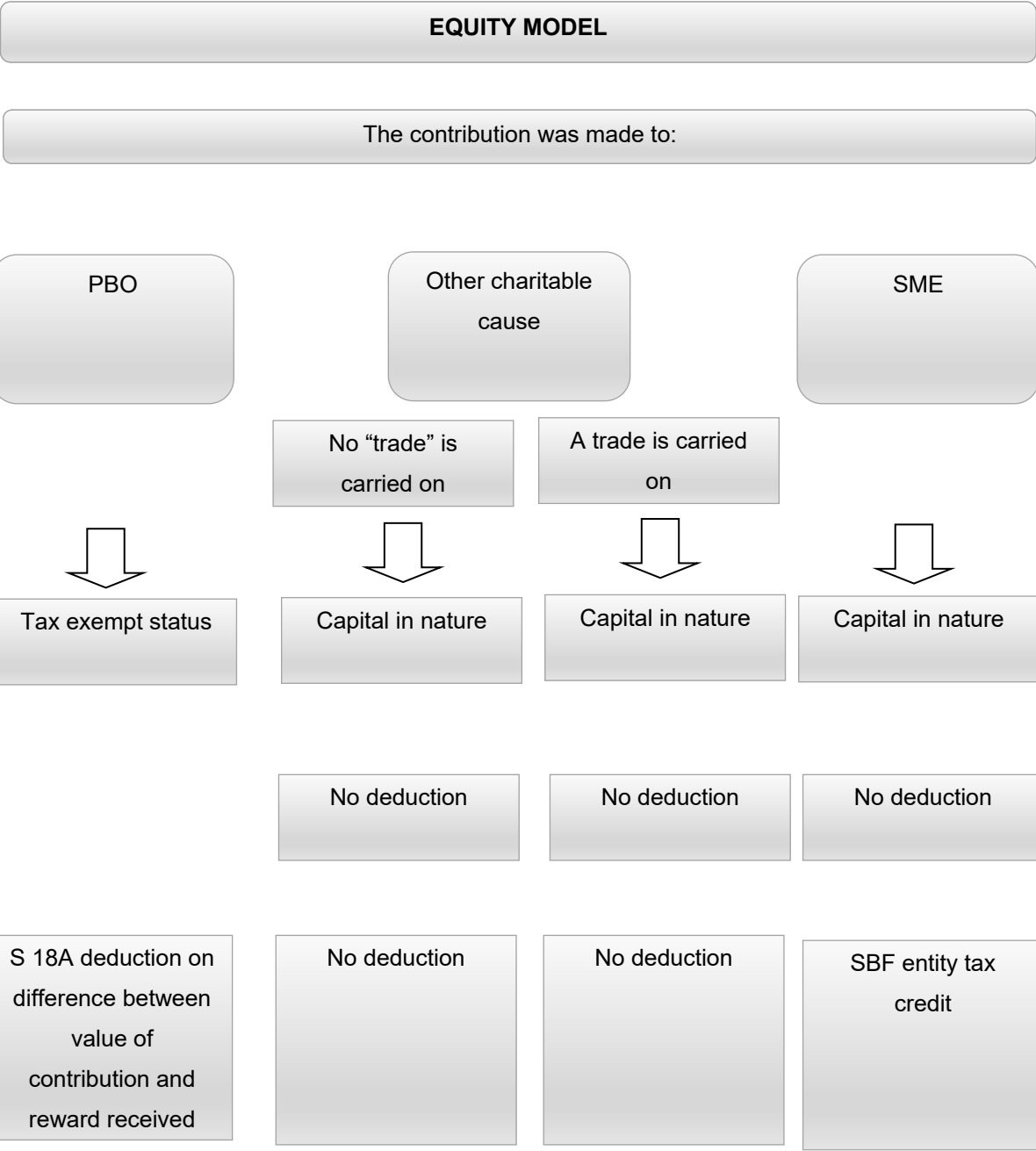


Figure 13: Equity model income tax implications (Own construct)

The recommendations from this study are compared to the policy considerations underpinning crowdfunding in SA. Table 10 constructed in Chapter 5 is therefore elaborated upon by adding recommendations as follows:

Table 54: Comparison of policy considerations with recommendations (Own construct)

Davis Tax Committee	NDP	Mirrlees Commission	OECD	Addressed by recommendations
<p>Efficiency: Generate sufficient income with minimum distortions to the economy. Decisions should not be predominantly influenced by the tax implications.</p>	<ul style="list-style-type: none"> Support small businesses through better coordination of activities in small business agencies, development finance institutions, and public and private incubators. Increase investment in social and economic infrastructure to lower costs, raise productivity and bring more people into the mainstream of the economy. 	<ul style="list-style-type: none"> Targeted tax measures should be used for small businesses instead of lower tax rates for all profits of all small businesses. The overall tax rates applied to income from employment, self-employment and distributed profits (such as dividends) need to be aligned much more closely. Deductions should be allowed for expenditure incurred in producing income and this principle should also be applied to saving and investment. 	<ul style="list-style-type: none"> Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection. Adopt principles of risk sharing for publicly supported SME finance. Encourage timely payments in commercial transactions and public procurement. Monitor and evaluate public programmes to enhance SME finance. 	<ul style="list-style-type: none"> The use of single tax credit provision ensures efficiency with minimum distortions to the economy. By encouraging crowdfunding, more people are brought into the mainstream of the economy. By encouraging crowdfunding, a range of financing instruments are supported for SMEs while ensuring financial stability and investor protection.
<p>Equity: Every citizen has to contribute to the income of the government in</p>			<ul style="list-style-type: none"> Strengthen SME access to traditional bank financing. 	<ul style="list-style-type: none"> The use of single tax credit provision for

Davis Tax Committee	NDP	Mirrlees Commission	OECD	Addressed by recommendations
<p>proportion to their ability and capacity to do so.</p>			<ul style="list-style-type: none"> • Enable SMEs to access diverse non-traditional financing instruments and channels. • Promote financial inclusion for SMEs and ease access to formal financial services, including for informal firms. 	<p>all crowdfunding models are proposed.</p> <ul style="list-style-type: none"> • Crowdfunding is encouraged initially in order to assist growth in small businesses where there is a lack of collateral. Thereafter, access to traditional bank financing will be easier.
<p>Simplicity: Taxes should be designed in a manner that is easy to understand and apply and should be collected at a time and in a manner that is convenient to the taxpayer.</p>	<ul style="list-style-type: none"> • Reduce the regulatory burden in sectors where the private sector is the main investor, such as broadband Internet connectivity, to achieve greater capacity and lower prices. 		<ul style="list-style-type: none"> • Enhance SME financial skills and strategic vision. • Design public programmes for SME finance which ensure additionality, cost effectiveness and user-friendliness. 	<ul style="list-style-type: none"> • The use of single tax credit provision ensures simplicity. • The use of single tax credit provision for all crowdfunding models is proposed. • A single regulatory document is proposed for crowdfunding • Guidelines are proposed for what

Davis Tax Committee	NDP	Mirrlees Commission	OECD	Addressed by recommendations
				<p>constitutes a donation.</p> <ul style="list-style-type: none"> Guidelines are proposed for what constitutes a trade.
<p>Transparency and certainty: The calculation of tax liabilities as well as the manner in which taxes are collected should be certain and transparent.</p>			<ul style="list-style-type: none"> Identify SME financing needs and gaps and improve the evidence base. Improve transparency in SME finance markets. 	<p>All of the proposals in this study are aimed at encouraging transparency and certainty pertaining to the tax implications.</p>
<p>Tax buoyancy: The tax system should be able to adjust in response to changes in the economic environment.</p>				<p>The proposals in this study encourage growth in the small business sector by providing incentives for investments through crowdfunding. Growth in the small business sector will generate taxable income and provide employment opportunities.</p>

9.5 SIGNIFICANCE OF THE STUDY

This is the first study performed on the taxation implications of crowdfunding from a South African perspective. An in-depth study of the regulatory implications of crowdfunding from a South African viewpoint, with the focus on taxation, was needed in order to be pro-active and to remain competitive in the global market.

From a theoretical perspective, this study examined different crowdfunding models, crowdfunding taxation and regulation both locally and internationally. The theoretical knowledge gathered in this way was considered in developing a framework to enhance a crowdfunding policy for the South African crowdfunding industry. It was shown that existing tax legislation, not explicitly referring to and/or designed for crowdfunding transactions, is not always sufficiently flexible to accommodate, or even encourage, the use of crowdfunding from small businesses. This study assists in developing and establishing policy and a distinct tax framework for the South African crowdfunding industry.

From a practical perspective, the findings and recommendations of this study may assist the National Treasury in creating specific crowdfunding tax legislation and other forms of legislation relating to the crowdfunding industry in South Africa. Furthermore, this study hopes to empower entrepreneurs and small businesses to understand and have certainty regarding the workings and tax implications associated with the different crowdfunding models in South Africa.

9.6 FUTURE RESEARCH

An in-depth study of other legislation such as the Companies Act, the Banks Act, the National Credit Act, and the FAIS Act that might apply to crowdfunding is recommended for further research. In addition, further comprehensive empirical studies on behaviours of funders from a South African viewpoint is needed. Other taxation implications, such as the VAT treatment of crowdfunding transactions, should be investigated.

9.7 CONCLUDING REMARKS

The small and medium-sized business sector represents a critical sector for the promotion of employment and economic growth in South Africa. However, one of the main challenges to the growth of the small and medium-sized business sector of the economy is access to capital. Crowdfunding is a valuable source of access to capital, especially for start-up businesses. It is a means of democratising investment opportunities in South Africa since it is an open call to any member of the public and is not bound only to certain sophisticated investors.

As was predicted more than a century ago, “The age we are about to enter will in truth be the era of crowds” (Le Bon, 1896:xiv-xv). Crowdfunding will continue to exist and expand, whether regulated or unregulated, as evident from the growth in various fundraising platforms as well as from the results of the interviews and survey instrument used. If left unregulated, tax evasion, tax avoidance and fraud can exist. Since crowdfunding is an open call to any member of the public (regardless of their demographics or level of financial literacy) it is necessary that clear, specific guidance and regulations should be promulgated for crowdfunding transactions that can be understood by any member of the public. The regulations should aim to prevent complex/hybrid structures, especially with equity and debt-based crowdfunding, and should strike a balance between inclusivity and efficiency.

A more flexible regulatory approach is needed to accommodate equity crowdfunding. It is proposed that the corporate form requirements of the Companies Act should be reconsidered, in order to be consistent with the broader ambitions of crowdfunding, as outlined in this study.

It is furthermore proposed that a single tax credit should be introduced for funders. By aligning provisions, certainty and fairness in the tax treatment of the different crowdfunding models will be promoted.

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ANNEXURE A

QUESTIONS FOR INTERVIEWS WITH PLATFORM OWNERS

Questions relating to research question 1 (What are the different crowdfunding models?)

1. Which crowdfunding model(s) does your platform support?
 - a. Donation
 - b. Reward
 - c. Debt
 - d. Equity
 - e. Other (please specify)
2. Please motivate why your platform chose the specified model(s).
3. From which date has your platform been active?
4. Can *project creators* who are not SA residents also create a project on your platform or is it restricted to SA residents only?
5. Can *funders* who are not SA residents also contribute to projects on your platform or is it restricted to SA residents only?
6. Which procedures and documentation do you require when dealing with a prospective *project creator*?
7. Which procedures and documentation do you require when dealing with a prospective *funder*?
8. Which regulations/laws/acts are applicable to your platform?
9. What are the challenges that you experience with regard to the regulation of crowdfunding transactions?
10. What are the risks that you have to deal with?
11. What type of income do you receive as platform from the following participants and how is the income calculated?
 - a. From the *project creator*
 - b. From the *funder*
12. What type of expenses do you incur as a platform?

Questions relating to research question 2 (What are the reasons and background for using crowdfunding?)

13. Do you think crowdfunding will remain/increase/disappear in future? Please explain.
14. What, in your opinion, is the main reason for *project creators* to use crowdfunding?
15. What, in your opinion, is the main reason for *funders* to contribute to projects?
16. What are the advantages of using crowdfunding?
17. What are the disadvantages of using crowdfunding?
18. Will you be able to provide me with information for statistical purposes relating to the project, project owner and funders such as:
 - i. number of projects to date?
 - ii. number of successfully funded projects?
 - iii. total amount of funding raised?
 - iv. crowdfunding model used by the projects?
 - v. geographical location of the successfully funded projects?
 - vi. geographical location of funders?
 - vii. relationship of funder to project owner (i.e., friend, family, non-related)?
 - viii. other (please specify)?

Questions relating to research question 4 (What are the tax implications of the different crowdfunding models currently in South Africa?)

19. Are you familiar with the tax consequences of crowdfunding for the following participants? Please explain.
 - a. Project creator
 - b. Platform
 - c. Funder
20. Do you think that the current tax legislation of South Africa encourages or discourages crowdfunding? Please explain.
21. Do you think crowdfunding should be taxed, and if so, how? Please explain.

General

22. Is there anything else that you think I should take into account in my research, which could be relevant to my research?

ANNEXURE B

1. INFORMED CONSENT

Department of Taxation

Tel No: 051 401 3841

Dear Respondent

SURVEY AMONGST ROLE PLAYERS IN CROWDFUNDING IN SOUTH AFRICA

Mrs A. Oosthuizen is doing research for a doctoral thesis in the College of Accounting Sciences at the University of South Africa (UNISA). The purpose of this research is to establish **A TAX FRAMEWORK FOR CROWDFUNDING IN SOUTH AFRICA.**

Your participation by completing the questionnaire attached will be appreciated. All responses will be treated as confidential. Data collected will only be used for statistical analysis. No individual or company-specific information will be revealed. Please do not hesitate to contact Mrs A. Oosthuizen at the above telephone number should you require any further information or assistance in completing the questionnaire.

Your valuable contribution in determining a tax framework for crowdfunding in South Africa is sincerely appreciated.

Yours faithfully

PROF. A.P. SWANEPOEL

COLLEGE OF ACCOUNTING SCIENCES – UNISA

GENERAL INFORMATION

- The purpose of this questionnaire is to establish a tax framework for Crowdfunding in South Africa. It is therefore important to research the current tax treatment of crowdfunding in South Africa.
- This questionnaire forms part of a research project to qualify for the degree of Doctor of Philosophy in Accounting Sciences (Taxation) at UNISA.
- The input of each respondent is very important for the purpose of this research project. The participation of each respondent is highly valued and will make a difference.
- The information supplied by you will be treated as **strictly confidential**. Your responses together with those of other respondents will be used to obtain a complete picture.
- Please answer every question/statement in the space provided in each question/statement by ticking the applicable section or type your answer where required.
- For the purpose of this research, the concepts of crowdfunding and the different crowdfunding models will be investigated.

Thank you for your cooperation and participation in making this research possible.

Mrs A. Oosthuizen

Telephone: Work: 051-041 3841

Mobile: 082 449 9433

Email: oosthuizen@ufs.ac.za

Promoter: Prof. A.P. Swanepoel, College of Accounting Sciences, UNISA

2. DEMOGRAPHIC INFORMATION OF RESPONDENTS

1. What is your gender?

- Male
- Female

2. What is your age?

- 20 - 30
- 31 – 40
- 41 – 50
- 51 – 60
- 60 +

3. What is your race?

- Black
- Coloured
- Indian
- White
- Other

4. Are you a South African resident?

- Yes
- No

5. In which province are you located?

- Eastern Cape
- Free State
- Gauteng
- Kwazulu-Natal
- Limpopo
- Mpumalanga
- North West
- Northern Cape
- Western Cape
- Other (please specify)

6. In which field are you occupied?

- Construction
- Education
- Entrepreneur
- Financial
- Private sector
- Public sector

Other (please specify)

7. How would you rate your level of expertise in investments and investment decisions (financial literacy)?

- Fundamental awareness
- Novice
- Intermediate
- Advanced
- Expert

8. Where did you get the link to the survey questionnaire?

- From the online crowdfunding platform
- From a friend who forwarded the link
- On Facebook
- From the link in the newsletter of the online platform
- Other (please specify)

3. **A: The different crowdfunding models**

1. Do you know what crowdfunding is?

- Yes
- No

2. If yes, where did you learn about crowdfunding?

- Facebook
- From a friend
- Internet
- Readings such as newspaper articles, magazines etc.
- Other

3. Which crowdfunding model(s) are you familiar with?

- Debt
- Donation
- Equity
- Reward
- Other (please explain)

4. Have you ever made contributions to a crowdfunded project?

- Yes
- No

5. Have you ever created a crowdfunded project for which you required funding?
- Yes
 - No

4. **B:The reasons and background for using crowdfunding**

Crowdfunding is an open call through the Internet to anybody to make contributions to a specific project. Depending on the crowdfunding model, the funding obtained can either be used for charitable purposes (such as paying the medical bills of a person) or can be used to fund the start-up cost of a small business. The parties to a crowdfunding transaction are the project owner (the person who raises the funding), the funders (the persons making the contributions, also referred to as the backers) as well as the platform (the website that facilitates the process).

1. For which of the following do you think crowdfunding is a viable means of obtaining funding?
 - Small businesses
 - Charities
 - Other (please specify)

2. Do you think everybody should be provided an opportunity to invest in a business, regardless of their knowledge level about investments?
 - Yes (please explain)
 - No (please explain)
 - Do not know

3. Do you think only banks should be allowed to provide funding to start-up businesses?
 - Yes (please explain)
 - No (please explain)
 - Do not know

4. Would you make use of crowdfunding to obtain funding for a project?
 - Yes (please explain)
 - No (please explain)
 - Do not know

5. Do you think access to capital is easily obtainable for entrepreneurs?
 - Yes (please explain)
 - No (please explain)
 - Do not know

6. What is the likelihood of risk associated with investing in a rewards-based crowdfunding project (an entrepreneurial business that offers you a product in return for a donation received)?

- Very likely
- Likely
- Possible
- Unlikely
- Very unlikely

7. Have you ever invested in a crowdfunding project?

- Yes
- No

a) If yes, please answer the following:

i. The type of project _____

ii. The name of the crowdfunding platform _____

iii. Why did you invest in the specific project?

- Out of pure generosity (i.e., to make a donation)
- The project is the project of a family member
- The project is the project of a friend
- To obtain a financial benefit
- To obtain a product (reward)
- To obtain the marketing benefit
- Other (please specify)

b) What incentive(s) did you expect to receive from the project that you invested in?

- Financial benefit
- Intrinsic benefit
- Product
- None
- Other (please specify)

c) Did you receive the expected benefit?

- Yes
- No (please specify why not)
- Not applicable

- d) Did you receive a tax benefit/deduction from investing in the project?
- Yes (please explain)
 - No (please explain)
- e) If you assume that you would have received a tax deduction/tax benefit for the amount invested, would it have had an influence on your decision to invest or not to invest?
- Yes (please explain)
 - No (please explain)

5. C: The tax implications of the different crowdfunding models currently available in South Africa

1. How would you rate the level of your general knowledge of the South African Income Tax Act?
- Fundamental awareness
 - Novice
 - Intermediate
 - Advanced
 - Expert
2. Are you familiar with the tax consequences of crowdfunding for the funder (donor)? Please explain.
- Yes (please explain)
 - No
3. Based on the current South African Income Tax Act, the following statement(s) is/(are) true with regard to the donee for **donations received** (select all the statements which are true):
- You must pay tax on the contribution **received** as a donation from somebody to assist you, a friend or a relative to pay a medical bill
 - You must pay tax on the contribution **received** as a donation from somebody to assist you in starting your own business.
 - You must pay tax on the contribution **received** as a donation only if you provide a product/service in return for the donation received.
 - None of the above
 - I do not know
4. Based on the current South African Income Tax Act, the following statement(s) is/(are) true with regard to the donor for **donations made** (select all the statements which are true):

- You can claim a tax deduction for a contribution **made** as a donation to somebody to assist them to pay a medical bill.
 - You can claim a tax deduction for a contribution **made** as a donation to somebody to assist them to start their own business.
 - You can claim a tax deduction for a contribution made as a donation only if you received a product/service in return for the donation made.
 - None of the above
 - I do not know
5. Do you think that the current tax legislation in South Africa encourages or discourages crowdfunding? Please explain.
- Encourages (please explain)
 - Discourages (please explain)
 - Do not know
6. Do you think funding received through crowdfunding should be taxed, and if so, how? Please explain.
- Yes (please explain how)
 - No (please explain how)
7. If you assume that you will receive a tax deduction for the amount invested in a project (a random project), will it encourage you to invest in that specific project?
- Yes
 - No
- a) How will you determine in which project to invest?
- b) In which kinds of projects would you invest in and why?
- c) Please rank the following in order of importance (1 being the main encouragement)?
- A tax benefit
 - Pure generosity (i.e., to make a donation)
 - The project is the project of a family member
 - The project is the project of a friend
 - To obtain a financial benefit
 - To obtain a product offered by the project
 - Other (please specify)

8. Do you have any other remarks which might be of value for this study? Please specify.

THANK YOU FOR YOUR VALUABLE TIME AND INPUT IN COMPLETING THIS QUESTIONNAIRE. YOU HAVE MADE A GREAT CONTRIBUTION TO THE OUTCOME OF THIS RESEARCH.

ANNEXURE C

The secondary research objectives were linked with the research questions in the table below. The table furthermore references the objectives and research question to the relevant chapters of the literature in this study. The interview and survey questions were then finally also linked. Please note that the numbering of the questions, as referred to in the main study, were used in the table below to avoid confusion.

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
1. To explore crowdfunding.	1. What are the different crowdfunding models?	Chapter 2.2 Different models of crowdfunding Chapter 2.3. Behaviour of funders	1. Which crowdfunding model(s) does your platform support?	<p>3. A: The different crowdfunding models</p> <p>1. Do you know what crowdfunding is?</p> <p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p>2. If yes, where did you learn about crowdfunding?</p> <p><input type="checkbox"/> Facebook</p> <p><input type="checkbox"/> From a friend</p> <p><input type="checkbox"/> Internet</p> <p><input type="checkbox"/> Readings such as newspaper articles, magazines etc.</p> <p><input type="checkbox"/> Other</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p>3. Which crowdfunding model(s) are you familiar with?</p> <p><input type="checkbox"/> Debt</p> <p><input type="checkbox"/> Donation</p> <p><input type="checkbox"/> Equity</p> <p><input type="checkbox"/> Reward</p> <p><input type="checkbox"/> Other (please explain)</p> <p>4. Have you ever made contributions to a crowdfunded project?</p> <p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p>5. Have you ever created a crowdfunded project for which you required funding?</p> <p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p>
			2. Please motivate why your platform chose the specified model(s).	
			3. From which date has	

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
			your platform been active?	
			4. Can project creators who are not SA residents also create a project on your platform or is it restricted to SA residents only?	<p>Demographic information of respondents:</p> <p>1. What is your gender?</p> <p><input type="checkbox"/> Male</p> <p><input type="checkbox"/> Female</p> <p>2. What is your age?</p> <p><input type="checkbox"/> 20 - 30</p> <p><input type="checkbox"/> 31 – 40</p> <p><input type="checkbox"/> 41 – 50</p> <p><input type="checkbox"/> 51 – 60</p> <p><input type="checkbox"/> 60 +</p> <p>3. What is your race?</p> <p><input type="checkbox"/> Black</p> <p><input type="checkbox"/> Coloured</p> <p><input type="checkbox"/> Indian</p> <p><input type="checkbox"/> White</p> <p><input type="checkbox"/> Other</p>
			5. Can funders who are not SA residents also contribute to projects on your platform or is it restricted to SA residents only?	

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p>4. Are you a South African resident?</p> <p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p>5. In which province are you located?</p> <p><input type="checkbox"/> Eastern Cape</p> <p><input type="checkbox"/> Free State</p> <p><input type="checkbox"/> Gauteng</p> <p><input type="checkbox"/> Kwazulu-Natal</p> <p><input type="checkbox"/> Limpopo</p> <p><input type="checkbox"/> Mpumalanga</p> <p><input type="checkbox"/> North West</p> <p><input type="checkbox"/> Northern Cape</p> <p><input type="checkbox"/> Western Cape</p> <p><input type="checkbox"/> Other (please specify)</p> <p>6. In which field are you occupied?</p> <p><input type="checkbox"/> Construction</p> <p><input type="checkbox"/> Education</p> <p><input type="checkbox"/> Entrepreneur</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<input type="checkbox"/> Financial <input type="checkbox"/> Private sector <input type="checkbox"/> Public sector <input type="checkbox"/> Other (please specify) 7. How would you rate your level of expertise in investments and investment decisions (financial literacy)? <input type="checkbox"/> Fundamental awareness <input type="checkbox"/> Novice <input type="checkbox"/> Intermediate <input type="checkbox"/> Advanced <input type="checkbox"/> Expert 8. Where did you get the link to the survey questionnaire? <input type="checkbox"/> From the online crowdfunding platform <input type="checkbox"/> From a friend who forwarded the link <input type="checkbox"/> On Facebook <input type="checkbox"/> From the link in the newsletter of the online platform <input type="checkbox"/> Other (please specify)
			6. Which procedures and documentation do you	

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
			require when dealing with a prospective project creator?	
			7. Which procedures and documentation do you require when dealing with a prospective funder?	
			8. Which regulations/laws/acts are applicable to your platform?	
			9. What are the challenges that you experience with regard to the regulation of crowdfunding transactions?	
			10. What are the risks that you have to deal with?	
			11. What type of income do you receive as platform from the following participants and how is	

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
			<p>the income calculated?</p> <p>a) From the project creator</p> <p>b) From the funder</p>	
			12. What type of expenses do you incur as a platform?	
	2. What are the reasons and background for using crowdfunding?	<p>2.4 Reasons for using crowdfunding</p> <p>2.5 Risks of using crowdfunding</p>	1. Do you think crowdfunding will remain/increase/disappear in future? Please explain.	<p>4. B: The reasons and background for using crowdfunding</p> <p>1. For which of the following do you think crowdfunding is a viable means of obtaining funding?</p> <p><input type="checkbox"/> Small businesses</p> <p><input type="checkbox"/> Charities</p> <p><input type="checkbox"/> Other (please specify)</p> <p>2. Do you think everybody should be provided an opportunity to invest in a business, regardless of their knowledge level about investments?</p> <p><input type="checkbox"/> Yes (please explain)</p> <p><input type="checkbox"/> No (please explain)</p> <p><input type="checkbox"/> Do not know</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p>3. Do you think only banks should be allowed to provide funding to start-up businesses?</p> <p><input type="checkbox"/> Yes (please explain)</p> <p><input type="checkbox"/> No (please explain)</p> <p><input type="checkbox"/> Do not know</p> <p>4. Would you make use of crowdfunding to obtain funding for a project?</p> <p><input type="checkbox"/> Yes (please explain)</p> <p><input type="checkbox"/> No (please explain)</p> <p><input type="checkbox"/> Do not know</p> <p>5. Do you think access to capital is easily obtainable for entrepreneurs?</p> <p><input type="checkbox"/> Yes (please explain)</p> <p><input type="checkbox"/> No (please explain)</p> <p><input type="checkbox"/> Do not know</p> <p>6. What is the likelihood of risk associated with investing in a rewards-based crowdfunding project (an entrepreneurial business that offers you a product in return for a donation received)?</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p> <input type="checkbox"/> Very likely <input type="checkbox"/> Likely <input type="checkbox"/> Possible <input type="checkbox"/> Unlikely <input type="checkbox"/> Very unlikely </p> <p>7. Have you ever invested in a crowdfunding project?</p> <p> <input type="checkbox"/> Yes <input type="checkbox"/> No </p> <p>a) If yes, please answer the following:</p> <p>i. The type of project _____</p> <p>ii. The name of the crowdfunding platform _____</p> <p>iii. Why did you invest in the specific project?</p> <p> <input type="checkbox"/> Out of pure generosity (i.e., to make a donation) <input type="checkbox"/> The project is the project of a family member <input type="checkbox"/> The project is the project of a friend <input type="checkbox"/> To obtain a financial benefit <input type="checkbox"/> To obtain a product (reward) </p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p> <input type="checkbox"/> To obtain the marketing benefit <input type="checkbox"/> Other (please specify) </p> <p> b) What incentive(s) did you expect to receive from the project that you invested in? </p> <p> <input type="checkbox"/> Financial benefit <input type="checkbox"/> Intrinsic benefit <input type="checkbox"/> Product <input type="checkbox"/> None <input type="checkbox"/> Other (please specify) </p> <p> c) Did you receive the expected benefit? </p> <p> <input type="checkbox"/> Yes <input type="checkbox"/> No (please specify why not) <input type="checkbox"/> Not applicable </p> <p> d) Did you receive a tax benefit/deduction from investing in the project? </p> <p> <input type="checkbox"/> Yes (please explain) <input type="checkbox"/> No (please explain) </p> <p> e) If you assume that you would have received a tax </p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p>deduction/tax benefit for the amount invested, would it have had an influence on your decision to invest or not to invest?</p> <p><input type="checkbox"/> Yes (please explain)</p> <p><input type="checkbox"/> No (please explain)</p>
			2. What, in your opinion, is the main reason for project creators to use crowdfunding?	
			3. What, in your opinion, is the main reason for funders to contribute to projects?	
			4. What are the advantages of using crowdfunding?	
			5. What are the disadvantages of using crowdfunding?	
2. To compare the tax implications of crowdfunding from an	3. What are the tax implications of the different crowdfunding models	Chapter 4		

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
international perspective using the theoretical construct as underpin.	internationally?			
3. To critically analyse the taxation of crowdfunding transactions from a South African perspective using the theoretical construct as underpin.	4. What are the tax implications of the different crowdfunding models currently in South Africa?	Chapter 6		<p>5. C: The tax implications of the different crowdfunding models currently available in South Africa</p> <p>1. How would you rate the level of your general knowledge of the South African Income Tax Act?</p> <ul style="list-style-type: none"> <input type="checkbox"/> Fundamental awareness <input type="checkbox"/> Novice <input type="checkbox"/> Intermediate <input type="checkbox"/> Advanced <input type="checkbox"/> Expert <p>2. Are you familiar with the tax consequences of crowdfunding for the funder (donor)? Please explain.</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p> <input type="checkbox"/> Yes (please explain) <input type="checkbox"/> No </p> <p>3. Based on the current South African Income Tax Act, the following statement(s) is/(are) true with regard to the donee for donations received (select all the statements which are true):</p> <p> <input type="checkbox"/> You must pay tax on the contribution received as a donation from somebody to assist you, a friend or a relative to pay a medical bill <input type="checkbox"/> You must pay tax on the contribution received as a donation from somebody to assist you in starting your own business. <input type="checkbox"/> You must pay tax on the contribution received as a donation only if you provide a product/service in return for the donation received. <input type="checkbox"/> None of the above <input type="checkbox"/> I do not know </p> <p>4. Based on the current South African Income Tax Act, the following statement(s) is/(are) true with regard to the donor for donations made (select all the statements which are true):</p> <p> <input type="checkbox"/> You can claim a tax deduction for a contribution made as a donation to somebody to assist them to pay a </p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<p>medical bill.</p> <ul style="list-style-type: none"> <input type="checkbox"/> You can claim a tax deduction for a contribution made as a donation to somebody to assist them to start their own business. <input type="checkbox"/> You can claim a tax deduction for a contribution made as a donation only if you received a product/service in return for the donation made. <input type="checkbox"/> None of the above <input type="checkbox"/> I do not know <p>5. Do you think that the current tax legislation in South Africa encourages or discourages crowdfunding? Please explain.</p> <ul style="list-style-type: none"> <input type="checkbox"/> Encourages (please explain) <input type="checkbox"/> Discourages (please explain) <input type="checkbox"/> Do not know <p>6. Do you think funding received through crowdfunding should be taxed, and if so, how? Please explain.</p> <ul style="list-style-type: none"> <input type="checkbox"/> Yes (please explain how) <input type="checkbox"/> No (please explain how) <p>7. If you assume that you will receive a tax deduction for the amount invested in a project (a random project), will it encourage you to invest in that specific project?</p>

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
				<input type="checkbox"/> Yes <input type="checkbox"/> No a) How will you determine in which project to invest? b) In which kinds of projects would you invest in and why? c) Please rank the following in order of importance (1 being the main encouragement)? <ul style="list-style-type: none"> <input type="checkbox"/> A tax benefit <input type="checkbox"/> Pure generosity (i.e., to make a donation) <input type="checkbox"/> The project is the project of a family member <input type="checkbox"/> The project is the project of a friend <input type="checkbox"/> To obtain a financial benefit <input type="checkbox"/> To obtain a product offered by the project <input type="checkbox"/> Other (please specify)
4. To determine to what extent the current tax	5. How should South African tax policies	Chapter 5 and Chapter 6	1. Are you familiar with the tax consequences of crowdfunding for the	

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
legislation dealing with crowdfunding transactions meet the objectives of the South African government.	be drafted or amended to ensure the effective and efficient taxation of crowdfunding transactions that are aligned with the objectives of the South African government?		following participants? Please explain.	
			2. Do you think that the current tax legislation of South Africa encourages or discourages crowdfunding? Please explain.	
			3. Do you think crowdfunding should be taxed, and if so, how? Please explain.	
5. To provide a framework for the		Chapter 9		

Research objective	Research questions	Reference to the literature	Interview questions	Survey questions
<p>creation/amen dment of tax legislation for crowdfunding transactions for South Africa that can be used in the development of formal crowdfunding tax provisions for South Africa.</p>				