CROWDFUNDING : WHAT ARE THE TAX ISSUES?

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Abstract
This paper seeks to analyse the different tax issues that arise for each party to a crowdfunding arrangement. There are currently four main types of crowdfunding arrangements. These are commonly referred to as donation-based crowdfunding, reward-based crowdfunding, equity-based crowdfunding and debt-based crowdfunding. Each uses a different strategy to attract funding and each may have different tax consequences for the parties involved.

In addition to income tax issues, the authors discuss GST in the context of reward-based crowdfunding and highlight the different results that arise under GST due to the different criteria for determining whether an enterprise is being carried on for GST purposes as opposed to a business for income tax purposes. With regard to equity and debt-based crowdfunding the authors also point out some of the limitations that arise due to regulatory control.

1. INTRODUCTION

Crowdfunding is a rapidly evolving industry[1] and in 2015 was estimated to be worth in excess of $2 billion for investment to start-up businesses worldwide.[2] Crowdfunding is the term used to refer to the practice of using internet platforms, mail-order subscriptions, benefit events and other methods to find supporters and raise funds for a project or venture.[3] Crowdfunding is intended to obtain [funds] from a large audience (the 'crowd'), where each individual will provide a very small amount. Crowdfunding has attracted the attention of the Parliament where the crowd is being offered an interest in a company – a share. But crowd funding is not limited to the situation of offering equity. It can take the form of a donation, a loan or pre-ordering of the product to be produced.[4]

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[1] For example in 2015 in the United Kingdom in excess of 250,000 crowdfunding campaigns were backed by more than a million people, Falk Kohlmann and Andreas Pages, 'Crowdfunding: An international comparison' in Andreas Dietrich and Simon Amrein, Crowdfunding Monitoring Switzerland 2016 (Lucerne School of Business, 2016) 39, 39.

[2] Nancy B Nichols and Blaise M Sonnier, 'Regulation Crowdfunding And Investor Taxation' (2017) Tax Notes 1237, 1237.

[3] Paul Belleflamme, Thomas Lambertz and Armin Schwienbacherxet, 'Crowdfunding: Tapping the right crowd', SSRN eLibrary (2012) 2.

[4] Paul Belleflamme, Thomas Lambertz and Armin Schwienbacherxet, 'Crowdfunding: Tapping the right crowd', SSRN eLibrary (2012) 2.

However, the use of the internet means that crowdfunding has attracted the interest of regulators and revenue authorities. In many crowdfunding situations there will be income tax (and possibly goods and services tax (GST)) issues arising from the crowdfunding activities.[5]

In any crowdfunding arrangement there are generally three parties.[6] First, there are the fundraisers or promoters, entrepreneurs and others, raising funds via a crowdfunding platform (Promoters). These Promoters use crowdfunding to gain access to the marketplace and to gather financial support from people who are interested in supporting their project.[7] Secondly, of great significance, are the investors or 'crowd' (Funders).[8] Finally, there is the Intermediary who works to arrange a match between Promoters and Funders by means of an online platform (Intermediary).[9] Each party may have income tax and GST obligations, depending on their circumstances and the nature of the crowdfunding arrangement.

There are currently four main types (or models) of crowdfunding. These are commonly referred to as donation-based crowdfunding, reward-based crowdfunding, equity-based crowdfunding and debt-based crowdfunding.[10] Each uses a different strategy to attract funding and each may have different tax consequences for the parties involved.

This paper seeks to analyse the different tax issues that arise for each party to the arrangement when entering into each of the different models of crowdfunding. It is positioned at a time that the use of these arrangements is becoming significant both financially and in terms of the number of participants.[11] In addition to income tax issues, the authors discuss GST in the context of reward-based crowdfunding and highlight the different results that arise under GST due to the different criteria for determining whether an enterprise is being carried on for GST purposes as opposed to a business for income tax purposes.

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[5] See Belle Jing, 'Income tax implications of investing in a combined share and rewards-based crowdfunding campaign in Australia' (2017) 46 Australian Tax Review 48, for a discussion of the taxation issues arising from a combined equity and rewards based arrangement.

[6] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.

[7] Andrea Ordanini, Lucia Miceli, Marta Pizzetti and A Parasuraman, 'Crowd-funding: transforming customers into investors through innovative service platforms' (2011) 22(4) Journal of Service Management 443; ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.

[8] Andrea Ordanini, Lucia Miceli, Marta Pizzetti and A Parasuraman, 'Crowd-funding: transforming customers into investors through innovative service platforms' (2011) 22(4) Journal of Service Management 443.

[9] Edan Burkett, 'A Crowdfunding Exemption? Online Investment Crowdfunding and U.S. Securities Regulation' (2011) 13 The Tennessee Journal of Business Law 63, 68.

[10] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.
There is also the possibility of a combination of these arrangements, see Belle Jing, 'Income tax implications of investing in a combined share and rewards-based crowdfunding campaign in Australia' (2017) 46 Australian Tax Review 48.

[11] As stated in footnote 1, in 2015 in the United Kingdom in excess of 250,000 crowdfunding campaigns were backed by more than a million people, Falk Kohlmann and Andreas Pages, 'Crowdfunding: an international comparison' in Andreas Dietrich and Simon Amrein, Crowdfunding Monitoring Switzerland 2016 (Lucerne School of Business, 2016) 39, 39.

II. WHAT IS INCOME FOR TAX PURPOSES?

A. *The Characteristics of Ordinary Income*

Before analysing each type of crowdfunding arrangement, it is important to consider what the characteristics of 'income' under the Australian income tax system are. It should be noted that there is no definition of income in the statute. Section 6-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) tells us that a taxpayer's assessable income (and ultimately taxable income) includes 'income according to ordinary concepts'. In determining if this provision applies, the courts have established that whether or not an amount is income is determined in accordance with the ordinary principles and usages of humankind.[12] Furthermore, these usages may vary over time.[13] The cases provide that all the relevant circumstances of the situation should be examined and that it is an objective test.[14] They have also established some relevant principles that indicate whether or not a receipt is income. These principles have over the years been expressed in many ways,[15] but can be summarised through the expression of four positive characteristics. First, income is a gain; second, income is a flow that comes in to a taxpayer; third, there is a difference between income and capital; and most significantly, there must be an income-earning activity, such as the provision of services[16] or carrying on a business.[17] Under Australian law, a capital gain may also be subject to tax.

A key issue then is whether the activity generating the payment in crowdfunding is the product of a business activity. Section 995-1 ITAA97 states that a business '*includes* any profession, trade, employment, vocation or calling, but does not include occupation as an employee'. This is a non-exhaustive definition and as such we are referred to the case law to flesh out what is meant by a business for income tax purposes. The case law also indicates that a common feature of income is that it is paid regularly and periodically.[18] However, even an infrequent gain may be so intimately connected with the business as to be an incident of the business and therefore ordinary income.[19] As the majority of the High Court in *Federal Commissioner of Taxation v Montgomery* said, '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'.[20]

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[12] Federal Commissioner of Taxation v Myer Emporium Ltd (1987) 163 CLR 199.

[13] Scott v Federal Commissioner of Taxation (1935) 35 SR (NSW) 212, 219 (Jordan CJ); Federal Commissioner of Taxation v Whitfords Beach (1982) 150 CLR 355; Federal Commissioner of Taxation v Myer Emporium Ltd (1987) 163 CLR 199.

[14] Hayes v Federal Commissioner of Taxation (1956) 96 CLR 47, 55.

[15] Ross Parsons, Income Taxation in Australia (Law Book Company Limited, 1985) developed 15 propositions of income in Chapter 2; Robin Woellner et al, Australian Taxation Law (22nd ed, CCH, 2012) [3-150]–[3-400].

[16] Brent v Federal Commissioner of Taxation (1971) 125 CLR 418; Federal Commissioner of Taxation v Dixon (1952) 86 CLR 540.

[17] GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation (1990) 170 CLR 124.

[18] GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation (1990) 170 CLR 124.

[20] (1999) 198 CLR 639, 663 (Gaudron, Gummow, Kirby and Hayne JJ).

The legislation requires that we first consider whether or not an amount is income; if it is we must determine if it is assessable to taxation as income rather than under capital gains tax (CGT).[21] If the amount is not income, it may still be a capital gain subject to CGT.

B. *The Characteristics of Carrying on a Business for Income Tax Purposes*

A consideration of the crowdfunding arrangements introduced in Part I of this paper lead by necessity into a more detailed discussion of what it means to be carrying on a business from an income tax perspective. This is because the ordinary proceeds of carrying on a business are income[22] and, in certain situations, other receipts from carrying on a business will be income.[23] This can include the proceeds from a one-off profit making transaction.[24]

There are major characteristics that the courts have looked for in determining whether or not a taxpayer is carrying on a business. These are: the presence of a profit motive when carrying on the activities;[25] whether the activities have a significant commercial purpose or character;[26] repetition and regularity of the activity; whether the activity is of the same kind and carried on in a similar manner to that of the ordinary trade in that line of business; organisation and commerciality of the activities and the size, scale and permanency of the activity.[27] Where these tests are not met the activity is better described as a hobby, a form of recreation or a sporting activity and may not be considered to be carrying on a business. The list of factors set out above from the cases must however be carefully considered and the answer as to whether an activity is a business or hobby will often depend on the facts of a particular case.[28] Sometimes some factors have been shown to be more important than others, and at other times different factors have been the most influential.[29] This makes it difficult to set out established guiding principles in this area. However some of the practical aspects that suggest a business is being carried on are registering a business name, the intention of making a profit rather than just earning some income, setting up a separate bank account for the business, keeping accounting records for the activities of the business, and whether the activities are operated from business premises.[30]

C. *The Goods and Services Tax and what is meant by carrying on an enterprise*

[21] ITAA97 s 118-20.
[22] Ferguson v Federal Commissioner of Taxation 79 ATC 4261.
[23] Federal Commissioner of Taxation v Montgomery (1999) 198 CLR 639; Federal Commissioner of Taxation v Cooling; Federal Commissioner of Taxation v Myer Emporium Ltd [1987] HCA 18.
[24] Federal Commissioner of Taxation v Myer Emporium Ltd (1987) 163 CLR 199.
[25] Thomas v Federal Commissioner of Taxation 72 ATC 4094.
[26] Federal Commissioner of Taxation v Stone (2005) 222 CLR 289, the case of a professional sportswoman.
[27] Federal Commissioner of Taxation v Murry (1998) 193 CLR 605; Spriggs & Riddell v Federal Commissioner of Taxation (2009) 239 CLR 1;
[28] ATO, TR97/11 Income tax: am I carrying on a business of primary production? 4 June 1997.
[29] Evans v Federal Commissioner of Taxation 89 ATC 4540; Graham D Hill, 'Flagging for the Courts the problems of the GST' (2000) 3(6) Tax Specialist 304.
[30] ATO, TR97/11 Income tax: am I carrying on a business of primary production? 4 June 1997; ATO, TR2005/1 Income tax: carrying on business as a professional artist 12 January 2005.

It is possible that GST may apply to crowdfunding arrangements even if income tax does not apply. GST is a tax on the supply of goods or services.[31] There are a number of threshold criteria for GST to apply. They are, that there must be a supply, the supply must be by a registered entity, the entity must be carrying on an enterprise in Australia and the supply must not be either GST-free or input taxed.[32] For the purposes of this discussion it is not necessary to discuss any of these criteria with the exception of whether or not the Promoter is carrying on an enterprise. This analysis is intended to demonstrate that there may be situations where even though income tax does not apply, GST could.

Section 9-20 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (the GST Act) defines an enterprise. The definition is substantially the same as that used in *A New Tax System (Australian Business Number) Act 1999* (Cth) (the ABN Act). The relevant parts of the definition for the purposes of this paper are that '(1) An enterprise is an activity, or series of activities, done (a) in the form of a business; or (b) in the form of an adventure or concern in the nature of trade'. Hobbies or recreational pursuits are specifically excluded from the definition.[33] A Promoter can also register for GST if they are intending to carry on an enterprise.[34] The first thing to consider is that the definition of enterprise refers to an act or series of acts. The acts can take the form of a single transaction, groups of related transactions or the entire operations of the entity.[35] The section also uses the words 'in the form of a business'. The definition of business in the GST Act[36] is the same as that used ITAA97. Therefore the discussion in section 2.2 is relevant and if the Promoter is carrying on a business for income tax purposes they are also eligible to be registered for GST.

There are three differences between income tax and GST for this discussion. First, the words 'in the form of' have the effect of extending the meaning of enterprise beyond entities carrying on a business.[37] An enterprise therefore includes the activities that, while they are not sufficient to meet the criteria for being regarded as a business, have the appearance or characteristics of business activities. For example, activities that, had they been undertaken for profit, would have satisfied the tests of a business.[38] In *Federal Commissioner of Taxation v Swansea Services Pty Ltd*[39] McKerracher J observed that the words 'in the form of' do not support a suggestion that form alone may prevail over substance. He did however say that these words:

> …have the effect of extending the reach of 'enterprise' to those activities which are in the form of a business but would not, in the ordinary meaning of 'business' be considered such. But the activity must still be reasonably intended to be profit making in the case of an individual and cannot for any entity simply be a private recreational pursuit or hobby.[40]

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[31] Guy Brandon, 'Taxation and crowdfunding - the start' (2015) 49(8) Taxation in Australia 446.
[32] GST Act s 9-5; Guy Brandon, 'Taxation and crowdfunding - the start' (2015) 49(8) Taxation in Australia 446.
[33] GST Act s 9-20(2)(b).
[34] GST Act s 23-10(2).
[35] ATO, MT 2006/1, The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number 1 July 2015 [153]
[36] GST Act s 195-1.
[37] Michael Norbury and Vanessa Ritzinger, 'A question of fact - what is an 'enterprise' for GST purposes?: Commissioner of Taxation v Swansea Services Pty Ltd' (2009) 44(4) Taxation in Australia 234, 236.
[38] Federal Commissioner of Taxation v Swansea Services Pty Ltd [2009] FCA 402.
[39] [2009] FCA 402.
[40] [2009] FCA 402 [99].

Second, the definition of enterprise also includes the words 'an adventure or concern in the nature of trade'. This choice of words indicates that enterprise includes a commercial activity that does not amount to a business. Isolated transactions with commercial characteristics potentially fall into this category.[41] Third, the use of the words 'in the form of' again extend the meaning of 'an adventure or concern in the nature of trade' so that it covers activities undertaken in the form of trade that, had they been done for profit, would satisfy the ordinary concept test of a business.[42]

Since the enactment of the GST Act there have been several cases[43] that deal with the issue of whether or not an enterprise is being carried on for GST purposes. These cases have all been situations where the taxpayer wished to be registered for GST so that they could claim input tax credits for the GST they had paid on relevant expenses.[44] The Australian Taxation Office (ATO) however disputed these claims and in all but one of the cases was successful. The cases turn very much on their facts but there are some relevant factors that can be ascertained from them. These factors are very similar to the factors discussed in the section dealing with carrying on a business for income tax purposes and include, that the activities are approached in a business-like way;[45] that business activities are characterised by system, repetition and regularity and use of a system and systematic conduct of the activity together with a pre-formulated policy and coupled with a carefully devised investment strategy.[46] A 2008 case dealing with taxpayers involved in book publishing suggests that a plan should be in place to show how a profit could be made and that the relevant activity should not be on a small scale.[47]

The only case where a taxpayer was successful in convincing the court that it was carrying on an enterprise for GST purposes, even though the activity could be viewed as a hobby, is *Federal Commissioner of Taxation v Swansea Services Pty Limited*.[48] Swansea was a private company effectively owned by Mr Satterley, a Western Australian property developer. In the eight years to November 2005, approximately $4.8 million was spent by Swansea on the acquisition of 225 antique items and 87 paintings. The acquisitions had been financed partly through loans to both the company (under which Mr Satterley, the taxpayer's officeholder, provided a personal guarantee) and to Mr Satterley personally. Despite the many acquisitions made by Swansea it did not sell any of the items acquired until November 2002. During the time of the acquisitions,

[41] AB v Federal Commissioner of Taxation 97 ATC 4945, 4961; Graham D Hill, 'Flagging for the Courts the problems of the GST' (2000) 3(6) Tax Specialist 304, 305.
[42] Andrew Maples, 'GST and An Enterprise: A Consideration of Trade in the Context of the Subdivision of Land' (2000) 3 Journal of Australian Taxation 440.
[43] D'Arcy and Commissioner of Taxation [2008] AATA 709; Taxpayer-1 and Taxpayer-2 v Commissioner of Taxation [2015] AATA 737; Goldberg v Commissioner of Taxation [2008] AATA 1045.
[44] Section 11-20 GST Act provides that an entity is entitled to input tax credits for its creditable acquisitions. Section 11-5 defines a creditable acquisition. There is a 'creditable acquisition' when: a person or entity acquires anything solely or partly for a creditable purpose; the supply is a taxable supply; there has been consideration for the supply; or the person or entity is liable to provide consideration and the person or entity is registered or required to be registered, for GST. Section 11-15 defines a creditable purpose and provides that a person or entity acquires a thing for a 'creditable purpose' to the extent it is acquired in carrying out an enterprise.
[45] D'Arcy and Commissioner of Taxation [2008] AATA 709.
[46] Federal Commissioner of Taxation v Swansea Services Pty Ltd [2009] FCA 402.
[47] Goldberg v Commissioner of Taxation [2008] AATA 1045 [35]; see also Woods v Deputy Commissioners of Taxation [1999] FCA 1589.
[48] [2009] FCA 402.

Swansea had no employees but was provided with services by employees within the Satterley Group. Contractors and consultants also provided expert advice on art to Swansea.[49] In coming to his conclusion McKerracher J confirmed the findings of fact of the AAT that the taxpayer was conducting its activities in accordance with a pre-formulated policy and investment strategy, that specialist consultants were retained, detailed records were kept, budgeting, insuring, storage and protection of the assets was carried out on a business like basis. He further noted that the sums involved in the investment were millions of dollars.[50] Swansea's purpose he concluded was to acquire and to hold artwork and antiques with a view to turning these to account when the circumstances were right in order to derive a profit.[51] The fact that the taxpayer did not make a profit was not considered to be a deciding factor and, as it had the intention to make a profit, the initial losses in sale did not prevent Swansea from making a profit in the future. It was therefore carrying on an enterprise for the purposes of the GST Act.[52]

Swansea is an unusual case, but it is certainly arguable that the lack of repetition of sales and lack of any profit, even though the art works had been owned for over 10 years, would weigh against the taxpayer establishing that it was carrying on a business for income tax purposes. The case does exemplify that there are circumstances, although probably rare, where an enterprise will be considered to be carried on for GST purposes even though a business is not for income tax purposes. This has implications for the Promoter in reward-based crowdfunding arrangements.

III. CROWDFUNDING ARRANGEMENTS

We will now turn to each of the types of crowdfunding scenarios referred to in Part I using the characteristics discussed in Part II to determine if the payments involved are income.

A. *Donation-Based Crowdfunding*

In donation-based crowdfunding, a Funder makes a payment (or 'donation') to the project or venture. They do not receive anything significant in return. In this scenario the ATO states that '[t]he contributor's 'donation' may simply be acknowledged - for example, on the crowdfunding website'.[53] This is unlikely to have any tax consequences for either the Funder or the Promoter.

The concept of pooling money and donating it in some manner as a basic principle of crowdfunding is nothing new. In the late 19th century the pedestal of the Statue of Liberty was partly financed by citizens of New York. In 1885, Joseph Pulitzer announced that he would print the name of every

[49] [2009] FCA 402 [12]; Michael Norbury and Vanessa Ritzinger, 'A question of fact - what is an 'enterprise' for GST purposes?: Commissioner of Taxation v Swansea Services Pty Ltd' (2009) 44(4) Taxation in Australia 234.
[50] [2009] FCA 402 [104].
[51] [2009] FCA 402 [105].
[52] [2009] FCA 402 [104]-[105].
[53] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/; Paul Battista, 'The Taxation of Crowdfunding: Income Tax Uncertainties and a Safe Harbor Test to Claim Gift Tax Exclusion' (2015) 64 Kansas Law Review 143; Brandee R Hancock and Monika N Turek, 'Risks
and Abuses of Crowdfunding for Charity' (2016) Tax Notes 1851.

contributor to the pedestal in the newspaper, the New York World. After five months, this campaign had raised $102,000 (the equivalent of just over US $3m today). Eighty percent of this amount had come from donors with less than a dollar donation.[54] If the amount paid is truly a gift, as discussed below, then there are no income tax consequences to the Promoter.

A gift is not ordinary income in Australia to the recipient, nor is there any statutory provision that makes it income.[55] In the case of *Scott v Federal Commissioner of Taxation*[56] a payment of money was made to a solicitor by a longstanding client. The solicitor, Scott, had been adequately remunerated for his services and the amount paid was unexpected and motivated by friendship. Several other gifts were also made by the donee at the same time. The court held that the amount paid was a gift and therefore not income.[57] The taxpayer had been properly paid for his services and the amount paid was unexpected. It also held that the motive of the donor may be relevant but it is seldom, if ever, decisive.[58]

The Funders in the Statue of Liberty scenario would therefore be making a gift, as, once the funds are released to the platform/intermediary or the ultimate Promoter they belong to the recipient, the Funders are paying the money voluntarily and the reward that they receive is of such a trivial nature as to not be any benefit or advantage. Nor would the trivial benefits that the Funders receive be in any way considered income under Australian law. They are not gains in respect of carrying on a business and not for the provision of services. But, what about the Promoter of the arrangement, this is discussed below.

B. *The Promoter*

As stated above, if the amount paid is truly a gift, in other words, it is paid voluntarily and no reward is provided in return, then it will not be income to the Promoter of the crowdfunding arrangement. A good example of a current donation-based project which is supported by the Intermediary Kickstarter[59] is L'Intersection.[60] Two individuals combined to raise funds to convert 'a beautiful Church into an art gallery/event space/ community place/residential loft'[61] in San Francisco, US. The website describes different levels of pledges, $10 or less has no physical reward, more than $10 but less than $25 and the contributor receives a digital postcard, higher contributions receive such items as a pillow case designed by an artist friend of the L'Intersection individuals and so on.[62]

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[54] 'The Statue of Liberty and America's crowdfunding pioneer', BBC News Magazine (online), 25 April 2013.
[55] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/Individuals/Income-and-deductions/Income-you-must-declare/Crowdfunding/.
[56] Scott v Federal Commissioner of Taxation (1966) 117 CLR 514.
[57] Scott v Federal Commissioner of Taxation (1966) 117 CLR 514, 526; See also ATO, Taxation Ruling, IT2764, 'Income tax: gifts to missionaries, ministers of religion and other church workers - are the gifts income?' 2 April 1992.
[58] Scott v Federal Commissioner of Taxation (1966) 117 CLR 514, 526.
[59] Kickstarter is discussed later in this paper.
[60] Although there are some rewards for more generous contributors as described in the paper.
[61] Kickstarter, New Life to an Old Church (2018) https://www.kickstarter.com/projects/theperfectcardigan/new-life-to-an-old-church?ref=nav_search&result=project&term=L'INtersection.
[62] Kickstarter, New Life to an Old Church (2018) https://www.kickstarter.com/projects/theperfectcardigan/new-life-to-an-old-church?ref=nav_search&result=project&term=L'INtersection.

If we consider the income tax position of L'Intersection, the Promoter, we must apply income tax law principles to determine if the amounts received are income. In the case of donation-based crowdfunding such as L'Intersection, it is unlikely that the Promoter is making a gain (unless they actually own the church, and this would be a capital gain anyway). They are restoring an old church to be used for community based purposes; they are not personally benefitting from the donations, but putting back into their local community. Importantly, they do not appear to be carrying on a business as they are not engaged in commercial activities with a profit-making intention. The rewards they provide to higher level pledges are not part of a business that they are starting, but showcase artistic endeavours of their friends. Furthermore, the amounts pledged are more akin to gifts. They are given to L'Intersection for their sole use and without any thought of valuable return in the form of goods or services. It is arguable that the pledges are not income to L'Intersection. However, if they rent out the renovated space any amount they receive would be income as it would be an amount or gain returned for the use of the property.

In fact, the L'Intersection arrangement is very similar to an example provided by the ATO.[63] The main facts of the ATO example are that the Coastalville Surf Lifesaving Club (CSLSC) owns a surf club building (surf club) in a town called Coastalville. The building is in a state of disrepair and CSLSC cannot afford to update and refurbish the surf club. It is therefore considering selling it to a property developer. The CSLSC is a charity. Four local residents lead a community group opposed to selling the surf club. They use an Intermediary to launch a crowdfunding project with the aim of raising funds to update the surf club, including repainting and replacing the slats on the deck. CSLSC is supportive of the project but is not able to assist financially or in any other material way. The community group dedicates its time voluntarily for the project's duration. The group establish a bank account and the fund raising is successful due to creative Twitter use by one of the group. At the end of two months, the project has received $2 million. All the funds received are to be used by CSLSC which has authorised the group to carry out its proposed activities.

The ATO states that in this example the funds raised by the four individuals of the community group are not assessable income because:

- it is a one-off transaction outside the ordinary course of business;
- there is no indication of a profit-making scheme or that the transaction is commercial in character; and
- the group's actions are not of a businesslike nature.[64]

Even if some form of good or service is received by the Funders, if the value of the contribution is far greater than the value of the reward received, it is arguable that this amount is in effect a gift and not a fee for goods or services.[65]

C. *The Funder*

[63] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.
[64] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.
[65] Thomas Linder, 'Crowdfunding and Taxation' in Andreas Dietrich and Simon Amrein, Crowdfunding Monitoring Switzerland 2016 (Lucerne School of Business, 2016) 33, 37.

The Funder is the person making the donation. The only issue for the Funder would be whether the contribution is a deduction (ITAA 97 s 8-1

D. *The Intermediary*

An example of an entity that acts as an Intermediary of donation-based (and also reward-based) crowdfunding is Kickstarter which is based in the US. Kickstarter is one of the most famous examples of crowdfunding in the artistic and creative spheres.[66] Kickstarter began as a for-profit corporation in 2009 however in order to ensure their social mission was integral to the corporation they reincorporated as a 'benefit corporation' in 2015.[67] Benefit corporations are for-profit private companies that are incorporated under state legislation in the US.[68] This legislation allows for a corporate structure but enshrines a social mission within its constitution.[69] Although they may not be required to comply with all corporate reporting requirements, they will nevertheless be liable for income tax as a corporation (unless specifically exempt[70]).

Kickstarter's website states that 'Investment is not permitted on Kickstarter. Projects can't offer incentives like equity, revenue sharing, or investment opportunities'.[71] Some entities do however offer a reward to their Funders eg early access to the product being funded, a limited edition product and so on. If so, this would be reward-based crowdfunding, but many individuals or organisations that use Kickstarter are solely asking for assistance in getting their idea off the ground.

Kickstarter applies a five per cent fee for successfully funded projects.[72] Projects that are unsuccessful incur no fees and are subject to an all-or-nothing policy. In other words, if a project fails to meet its funding goal, none of the donation commitments made are actually processed.[73] Kickstarter states that this policy ensures a level of security for project creators and backers.[74] A good example of how this works is L'Intersection as discussed above.[75] Another example from Kickstarter is 'Fallen Fruit of New Orleans: The Endless Orchard'.[76] In this project, artists are

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[66] Kickstarter, Kickstarter (2018) https://www.kickstarter.com/about?ref=about_subnav.
[67] Kickstarter, Kickstarter (2018) https://www.kickstarter.com/about?ref=about_subnav.
[68] In this case Kickstarter is a benefit corporation under article 17 Business Corporation Law, New York State, Department of State, Corporations, State Records & UCC https://www.dos.ny.gov/corps/benefit_corporation_formation.html.
[69] Kickstarter has a series of mission statements including 'Kickstarter's mission is to help bring creative projects to life' https://www.kickstarter.com/charter?ref=hello.
[70] Some not-for-profit entities may be exempt from income tax, see ITAA97 div 50.
[71] Kickstarter, Our Rules, Projects Can't Offer Equity (2018) https://www.kickstarter.com/rules?ref=global-footer.
[72] Kickstarter, Kickstarter and Taxes (2018) https://www.kickstarter.com/help/taxes.
[73] Kickstarter, Kickstarter and Taxes (2018) https://www.kickstarter.com/help/taxes; Chance Barnett, 'Donation-Based Crowdfunding Sites: Kickstarter Vs. Indiegogo', Forbes (online), 9 September 2013 https://www.forbes.com/sites/chancebarnett/2013/09/09/donation-based-crowdfunding-sites-kickstarter-vs-indiegogo/#2c40450d15e0.
[74] Chance Barnett, 'Donation-Based Crowdfunding Sites: Kickstarter Vs. Indiegogo', Forbes (online), 9 September 2013 https://www.forbes.com/sites/chancebarnett/2013/09/09/donation-based-crowdfunding-sites-kickstarter-vs-indiegogo/#2c40450d15e0.
[75] Although there are some rewards for more generous contributors as described in the paper.
[76] Kickstarter, Fallen Fruit of New Orleans: The Endless Orchard (2018) https://www.kickstarter.com/projects/1770851316/fallen-fruit-of-new-orleans-the-endless-orchard.

raising funds to work in partnership with two government departments of the City of New Orleans to plant networks of publicly accessible fruit trees.

Kickstarter are carrying on a business: it has a corporate structure (ie it is a benefit corporation) which is a commercial entity, it has a sophisticated website and software that enables it to undertake its activities, it is therefore clearly engaging in commercial operations, the activities are regular and systematic, highly organised and it receives a fee from successful campaigns based on the amount raised. Kickstarter clearly has a profit-making intention, even if profit making is not its sole aim. It is clear that the proceeds of this business, be it the five per cent fee or advertising income from all the advertising that appears on their website, is income. In fact, Kickstarter actually state that they pay income tax, and, that for the 2016 tax year their effective tax rate was 25 per cent.[77]

An Australian example of an Intermediary of donation-based crowdfunding with a slightly different orientation to Kickstarter is Chuffed.[78] Chuffed.org was established in 2013 and its stated mission was to transform and improve the nature of non-profit fundraising. The organisation was first registered as a company limited by guarantee. However, the desire to grow the business and attract venture capital while at the same time maintaining its social mission, resulted in this organisation transforming from a non-profit entity to a hybrid for-profit business which is incorporated as a proprietary company.[79] Chuffed operates in a similar manner to Kickstarter. However, the projects that it assists are required to have a social, community or political cause and, unlike Kickstarter, promoters can include charities and not-for-profits.[80] Chuffed charges fees and also operates courses that are also fee paying.[81] Chuffed are clearly carrying on a business and all proceeds of the business will be assessable income.

E. *Reward-Based Crowdfunding*

Reward-based crowdfunding is a very popular form of crowdfunding.[82] This approach means that Funders receive a reward for backing a project. This might be being credited in a movie, having creative input into a product under development, or being given an opportunity to meet the creators of a project. Funders may also be early customers, so that they are allowed access to the products produced by funded projects. This is often at an earlier date, better price, or with some other special benefit. Mollick states that '[t]he "pre-selling" of products to early customers is a common feature of those crowdfunding projects that more traditionally resemble entrepreneurial ventures, such as projects producing novel software, hardware, or consumer products'.[83] The music platform SellaBand, discussed below is an example of reward-based crowdfunding.

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[77] Kickstarter, Kickstarter 2016 Benefit Statement (2018) https://www.kickstarter.com/year/2016/benefit-statement.
[78] Chuffed, We help you take action on issues you care about (2018) https://chuffed.org/.
[79] Prashan Paramanathan, 'Introducing the Social Benefit Company – A New Legal Structure for Australian Social Enterprises' on Chuffed Blog (January 2016) https://chuffed.org/blog/the-social-benefit-company.
[80] Chuffed, Before you Start, Are you Eligible? (2018) https://chuffed.org/how-it-works-crowdfunding/before-you-start.
[81] Chuffed, Our fees are the lowest (2018) https://chuffed.org/fees.
[82] Ethan Mollick, 'The dynamics of crowdfunding: An exploratory study' (2014) 29 Journal of Business Venturing 1, 3.
[83] Ethan Mollick, 'The dynamics of crowdfunding: An exploratory study' (2014) 29 Journal of Business Venturing 1, 3.

If the reward is the right to share in the proceeds or profits of the venture it may be that what is being offered is an interest in a 'managed investment scheme' (MIS). These schemes are regulated under Ch 5C of the *Corporations Act 2001* (Cth). A report by the Corporations and Markets Advisory Committee (CAMAC) in 2014 noted that this could be the case.[84]

F. *The Promoter*

It is arguable that in many reward-based crowdfunding arrangements the Promoter is carrying on a business. As stated in the discussion in Part II, the source of the activity generating the payment is relevant to determine if an amount is ordinary income. If the Promoter is engaged in regular and systematic commercial activities, with a profit-making intention and makes a profit then it is likely that they are carrying on a business and the funds received by them will therefore be income. The bands that put their music on the SellaBand site and who reached the threshold $50,000 were entitled to the commercial production of their music and they were then part of a profit sharing agreement with SellaBand. These are all characteristics of carrying on a business and the proceeds would be ordinary income.

In some situations however, the reward-based crowdfunding activity or project will be a creative endeavour such as painting, music or producing a movie. In some of these instances it may be hard to determine if the activity is really the carrying on of a business as it might be more akin to a hobby. Australian taxation law draws a distinction between businesses and hobbies and states that any income arising from a hobby is not assessable to income tax. As the court stated in *Ferguson v Federal Commissioner of Taxation* 'if what he is doing is more properly described as the pursuit of a hobby or recreation or an addiction to a sport, he will not be held to be carrying on a business even though his operations are fairly substantial'.[85] However, in another case the court indicated that if the distinction is between a hobby/recreational activity and a business the size and scale of the undertaking will be important.[86]

The question whether a taxpayer's activities should be characterised as a business is a matter of general impression and degree.[87] The characteristics discussed in Part II must be considered and applied to the facts of the crowdfunding arrangement. The cases are also often framed around the question of whether a business is carried on so that the taxpayer can claim expenses that relate to the activity as deductions against any income from the business/hobby activity and also from any other income that they derive. The 2006 case of *Pedley v Federal Commissioner of Taxation*[88] is an example of how difficult it can be to determine if an activity that is often a hobby is also a business. In this case, the taxpayer had worked as a professional artist for 20 years and was qualified as an artist. She had a studio, employed an accountant, had a website and sought to publicise her work. Over the years, she took part in many exhibitions but made few sales or commissions. Her activities were funded in part by income from lecturing in art and by artistic

[84] CAMAC, Crowd Sourced Equity Funding Report, May 2014 http://www.camac.gov.au/camac/camac.nsf/0/3dd84175efbad69cca256b6c007fd4e8.html 161, 175.
[85] Ferguson v Federal Commissioner of Taxation 79 ATC 4261, 4264-4265
[86] Woods v Deputy Commissioners of Taxation [1999] FCA 1589 [35], [37].
[87] Ferguson v Federal Commissioner of Taxation 79 ATC 4261, 4271; Charlene D Luke, 'Crowdfunding: Federal Income Tax Consideration' (2017) 58 Tax Management Memorandum 331, 338.
[88] [2006] AATA 108.

grants. During the ten years prior to the income year in question she had made very little income from the sales of her work.[89] The Administrative Appeals Tribunal (AAT) held that the taxpayer had more than an intention to carry on business as an artist. The Tribunal found that her career in this respect was her major occupation to which other activities were subordinate. Although the taxpayer had been unsuccessful in commercial terms, it was not necessarily the case that this would always be so[90] and she was held to be carrying on a business.

The High Court has considered this same issue in the case of a sportswoman in *Commissioner of Taxation v Stone*.[91] The taxpayer was a full-time policewoman who derived substantial amounts of money as a javelin thrower. The Court held that she was carrying on a business as a professional sportsperson. The Court noted that she wanted to compete at the highest level. This meant that she needed significant funds in order to pay for training, travel and equipment. As a result she sought and was successful in gaining sponsorship. She also accepted grants that were made to her and agreed to the commercial restrictions that were part of these grants. Her pursuit of her ambitions meant that she received prizes, increased money from grants, and the opportunity to obtain more generous sponsorship arrangements. Taking all these factors into consideration she had turned her sporting advantage to economic profit and was carrying on a business.[92]

The ATO website provides a good example of a crowdfunding arrangement where the Promoter is not considered to be carrying on a business, but rather a hobby.[93] The essential facts of the scenario are that the Promoter, Georgina, wants to make a film. She doesn't have the funds, so she establishes a project on a crowdfunding website. She has previously produced a film but funded it herself and did not make a profit as she only sold a handful of copies through social media. She is employed full-time with a company that is not involved in any way with the film making project. In return for funding, Georgina offers, by way of the crowdfunding platform, a digital video disc of the film. She does not intend to offer the film for public sale in any format at this time. The Intermediary that operates the website does so on the basis that unless all the money is raised the funds will be returned to the investors, the same as Kickstarter. If the funding target is met, Georgina will use all the funds for the project and she does not intend to keep any funds for herself or draw personal wages from it.

The ATO considers that the money Georgina receives through crowdfunding is not assessable income because she is not carrying on a business. She does not demonstrate a profit-making motive, she has not previously profited from her films and the project is not a commercial transaction or business operation. Furthermore, she is employed full-time in a separate industry and film-making is something she enjoys and is interested in, so merely a hobby. The ATO does point out that Georgina may be in the preparatory stages of a business, but there would need to be further business like activities for a business to have commenced.

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89 [2006] AATA 108 [26].

90 [2006] AATA 108[44], [52]; ATO, Income tax: carrying on business as a professional artist, TR 2005/1, 6 May 2009, [95B].

93 ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.

G. *The Funder*

There are no tax consequences for the Funder. The Funder is not carrying on a business and the payment to the promoter is not incurred in earning assessable income.

H. *The Intermediary*

In the case of reward-based crowdfunding, there will be an Intermediary and possibly a second Promoter. Such an entity is necessary to encourage and manage the campaign, to raise funds and hold funds, and transfer this money to the campaign or organisation that is being funded.

Although no longer operating, SellaBand was an online music platform that commenced in 2006 and which operated successfully for a number of years. It is a good example of how a typical crowdfunding arrangement occurs in the creative area. SellaBand is an example of a reward- based arrangement, where it is the Intermediary. SellaBand was based in Amsterdam and enabled musicians to raise money to produce their albums. SellaBand used the following business model. First, artists would post a number of songs on the SellaBand internet platform; then visitors to the site would be able to listen to the music free of charge and choose the artists they wanted to invest in; the artists would seek to raise $50,000 by selling segments of their music at $10 each; and during the fundraising stage, money was held in an escrow until the threshold of $50,000 was reached. The $50,000 was used to fund the artist's recording. If this all happened successfully, the investors (described as 'Believers'), would receive a limited edition CD of the album and, in really successful situations, 10 per cent of the artist's net revenue from the sale of the album.[94] If the $50,000 threshold was not reached the Believers would receive their money back or could donate it to another artist.[95] The arrangement with the artists was that they received one third of all advertising revenue from their profile, and 60 per cent of proceeds from eventual album sales. They also got all rights back to their music a year after the album came out.[96]

SellaBand was the Intermediary and second promoter in this arrangement. If we consider the characteristics of carrying on a business discussed in Part II, SellaBand is engaging in commercial operations, they have a corporate structure which is a commercial entity, they have a sophisticated website and software that enables them to undertake their activities, the activities of SellaBand are regular and systematic, they are highly organised and it appears that the founders entered into a profit sharing arrangement with the artists so they made a profit, at least initially, and had a profit making intention.[97] SellaBand were clearly carrying on a business and the proceeds of such a business, be it advertising income, or a share of the profits from the sale of music would be assessable income.

I. *Equity-Based Crowdfunding*

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[94] Richard Florida, 'SellaBand', The Atlantic (online) 17 June 2009 https://www.theatlantic.com/national/archive/2009/06/sellaband/19329/.

[95] Mike Butcher, 'SellaBand wins $5 million in Series A', on Techcrunch (8 April 2008) https://techcrunch.com/2008/04/08/sellaband-wins-5-million-in-further-funding/.

[96] Michael Arrington, 'SellaBand Music Model Gaining Traction', on Techcrunch (29 March 2007) https://techcrunch.com/2007/03/29/sellaband-music-model-may-be-working/.

[97] SellaBand successfully raised $5m Euros in their first round, Mike Butcher, 'SellaBand wins $5 million in Series A', on Techcrunch (8 April 2008) https://techcrunch.com/2008/04/08/sellaband-wins-5-million-in-further-funding/.

Equity-based crowdfunding is a variation on the rewards based funding where the Funder receives shares in a company. There are significant legal rules surrounding this type of crowdfunding both in Australia and overseas. Under the *Corporations Act*, an offer by the Promoter to issue shares in a company in exchange for a payment would breach the rules dealing with offerings of securities unless a disclosure document was prepared. As the preparation of such a document is extremely expensive and time-consuming, small scale Promoters were unable to access the market. In 2017 the *Corporations Act* was amended to provide a legislative framework for crowd-sourced funding (CSF) by public companies.[98] The CSF regime is intended to reduce the regulatory requirements for small-scale public fundraising while maintaining appropriate investor protection measures. One of these protective measures is that a provider of CSF services must hold an Australian financial services licence.[99] Such a provider will be an Intermediary and will receive fees from the Promoter. Until recently the rules permitting CSF was limited to public companies.

The issue of the appropriate level of investor protection in the area of equity crowdfunding is not unique to Australia. Investors in the US for example, have until recently found it very difficult to participate in crowdfunding in exchange for equity. The main issue is that general solicitations to the public for equity offerings are limited to companies that are publicly listed.[100] In 2012, the US government passed the *Jumpstart Our Business Startups Act*, or JOBS Act. This law is intended to encourage funding of small businesses in the US by easing many of the country's securities regulations. The rules surrounding equity-based crowdfunding in the US are still however complex with one commentator labelling the rules as 'costly, bureaucratic, and exclusionary'.[101] The situation looks brighter in Australia. In January 2018, Minister for Revenue and Financial Services Kelly O'Dwyer, confirmed in a statement that crowdfunding Intermediary licences had been issued to seven Australian equity crowdfunding platforms: Big Start, Billfolda, Birchal Financial Services, Equitise, Global Funding Partners, IQX Investment Services and On-Market Bookbuilds.[102]

J. *The Promoter*

From the Promoter's perspective, any funds they receive will not be income in their hands. Rather, these funds will form part of the share capital of the company undertaking the proposed project. Further, the issuing of shares does not give rise to CGT. The Promoter will not be entitled to a deduction for dividends paid to investors holding shares or other equity interests, but may be able

[98] A discussion of the Corporations Act implications can be found at Catie Moore, 'Equity Crowdfunding in Australia: How Far Have We Come and Where to Next?' (2017) 35 C & SLJ 102.
[99] Corporations Amendment (Crowd-sourced Funding) Act (Cth) 2017 amends the Corporations Act (Cth) 2001. It also makes minor amendments to the Australian Securities and Investments Commission Act (Cth) 2001.
[100] Paul Belleflamme, Thomas Lambertz and Armin Schwienbacherxet, 'Crowdfunding: Tapping the right crowd', SSRN eLibrary (2012) 2.
[101] Erik Gordon, 'The JOBS Act Trojan Horse: A Gift to Startups with Something Else Inside?' (2014) 3(2) Michigan Business & Entrepreneurial Law Review 213; Robb Mandelbaum, 'Should you Crowdfund your next business?' (2014) https://www.inc.com/magazine/201405/robb-mandelbaum/jobs-act-crowdfunding-problems.html.
[102] Kelly O'Dwyer, 'Australian companies take up crowdfunding opportunity' Media Release, 11 January 2018 http://kmo.ministers.treasury.gov.au/media-release/003-2018/.

to attach a franking credit to those distributions (reflecting any tax paid by the company).[103] The Promoter will need to consider whether withholding tax applies to distributions made to overseas shareholders.[104]

K. *The Funder*

In equity-based crowd funding investors will have ownership rights in the company and any shares that they receive may have certain rights attached to them, such as the right to vote, receive a return of capital on winding up of the company and/or a right to dividends. These investors will have an income tax liability for any dividends they receive.[105] If they sell the shares there will be CGT consequences, although a discussion of this aspect is outside the scope of the paper. Any return of capital to the investor shareholder will reduce the cost base of the shares for CGT purposes, but will not be income. For shareholders, the funds they contribute to an equity-based crowdfunding promoter are not deductible; they are the purchase price of the shares. There are also certain restrictions in Australian law around selling shares as part of a crowdfunding strategy, as discussed above, however a discussion of this legislation is also outside the scope of this paper. If the shareholder borrows money to purchase the shares, they may be entitled to a deduction for interest on this loan.[106]

L. *The Intermediary*

If there is an Intermediary, and they receive some form of fee for service or percentage of funds raised, the same principles as discussed in respect of income and carrying on a business in Part II must be applied to the facts of the situation to determine whether any amounts that the Intermediary receives are income. An example of an Australian Intermediary for equity-based crowdfunding is Equitise.[107] Equitise states that by:

> Bringing Investors and Companies together, the Equitise Investment Platform simplifies the investing process. It removes traditional barriers to investing and sourcing capital by making the process quick, easy and safe. In doing so, we help businesses grow.[108]

The usual fee structure is that Equitise charges a one off fee of 7.5 per cent of the capital raised. It also charges a fixed cost for time spent and the use of Equitise Nominees Limited, which administers the transaction and the investors. The latter fee may vary depending on the input required by Equitise to manage the transaction.[109] Clearly they are operating in an analogous

[103] ITAA97 div 205. A franking credit is usually only available if company tax has either been paid by the start-up company or it has received franked dividends. The start-up company has certain eligibility requirements including that it is an Australian resident company.
[104] ATO, Income and Deductions, Crowdfunding (21 June 2017) https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/.
[105] ITAA36 s 44(1) provides that dividends received by Australian shareholders are part of assessable income.
[106] Federal Commissioner of Taxation v Ilberry 81 ATC 4661
[107] Equitise, Equitise (2014) https://equitise.com/.
[108] Equitise, Platform FAQS, What is Equitise? (2014) https://equitise.com/faq.
[109] Equitise, Platform FAQS, What fees are charged? (2014) https://equitise.com/faq.

manner to Kickstarter or SellaBand discussed earlier in this paper, and these amounts will in all likelihood be income as the proceeds of carrying on a business.

M. *Debt-based Crowdfunding*

The final form of crowdfunding is debt-based crowdfunding. This form of crowdfunding involves a loan by a contributor to a Promoter. The Promoter agrees, in return for the loan, to pay interest to the contributor and to ultimately repay the principal after a fixed period. There are a variety of types of debt instruments that are available to investor contributors. Some of the instruments allow for conversion into shares so that investors have the potential to share in the company's growth while they receive steady interest payments. Other types of instruments are straight interest yielding securities. There are also secured and unsecured debt instruments.[110] A debt interest will also be a security under Ch 6D of the *Corporations Act*.[111] Although the *Corporations Act* permits simplified disclosure for an offer of an equity interest, this does not extend to debt interests. CAMAC in its 2014 report noted that some other jurisdictions did permit the issuance of either debt or equity under crowd sourced funding rules but the Committee recommended against such an approach in Australia on the basis that debt 'involve(s) different investor expectations and [that there are] some important differences in regulatory arrangements'.[112] This may mean that in Australia, the use of crowd funding for debt is too difficult to implement.

N. *The Promoter*

The loan moneys to the Promoter are not assessable income. However, the interest expense incurred by the Promoter will be deductible if it is incurred in gaining or producing assessable income or in carrying on a business in accordance with ITAA97 s 8-1 or div 230.[113]

O. *The Funder/Lender*

The interest received or receivable by the Funder/Lender will be assessable income as it represents a return for the use of capital by another.[114] This interest income will generally be derived when received,[115] although certain contributors may be required to recognise the income on what is referred to as an accruals (receivable) basis.[116]

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[110] Jason Futko, Online journal Crowdfund Insider, 24 September 2014 https://www.crowdfundinsider.com/2014/09/50628-equity-vs-debt-crowdfunding/.

[111] Corporations Act s 700.

[112] CAMAC, Crowd Sourced Equity Funding Report, May 2014 http://www.camac.gov.au/camac/camac.nsf/0/3dd84175efbad69cca256b6c007fd4e8.html 1.

[113] New Zealand Flax Investments Ltd v Federal Commissioner of Taxation (1938) 61 CLR 179.

[114] CCH Commentary, Australian Income Tax Guide (online), Interest as Income [2-450].

[115]see DG Hill, 'The Interface Between Tax Law And Accounting Concepts And Practice As Seen By The Courts' (2005) 1(1) Journal of The Australasian Tax Teachers Association 1.

[116]; see DG Hill, 'The Interface Between Tax Law And Accounting Concepts And Practice As Seen By The Courts' (2005) 1(1) Journal of The Australasian Tax Teachers Association 1.

It is possible that Funders may be able to claim a deduction for specific fees and other costs they incur (such as borrowing costs) for managing the loans that they make in respect of this type of crowdfunding arrangement. This is because these expenses would be incurred in gaining or producing assessable income (the interest) or in carrying on a business and therefore deductible under ITAA97 s 8-1 or div 230.[117]

P. *The Intermediary*

As noted above in relation to equity-based crowdfunding, the Intermediary will receive fees for the services provided to the Promoter and those fees will be assessable income.

IV CONCLUSION

Crowdfunding is not new, but the manner by which it is is certainly more sophisticated than it was at the beginning of the twentieth century when the Statue of Liberty needed a plinth. The different approaches to crowdfunding have been examined in this paper and the discussion demonstrates that each approach requires careful analysis from an income tax perspective in order to determine in what situations and on what taxpayers, income tax liability is likely to fall.

This paper has demonstrated that, at the end of the day, the material facts of each crowdfunding approach must be examined in order to then correctly apply the characteristics of ordinary income that have been expounded in Part II. In many cases, the question will be whether or not a business is being carried on and the cases tell us that this is a question of fact and degree. Where an activity is also often carried on as a hobby, this will be even more difficult. The source of the activity that produces funds will be a crucial aspect of the analysis and any funds must be considered in terms of the taxpayer entity receiving them. That this is complicated, and not always an easy task is demonstrated by the discussion in this paper.

[117] An example of how s 8-1 operates is found in W Neville & Co v Federal Commissioner of Taxation (1937) 56 CLR 290. In this case the High Court allowed a deduction for an amount paid to the managing director to encourage him to resign early. The Court considered that the expense was made to increase the efficiency of the company which, in turn, would increase its income producing capacity. The Court held that for income tax purposes it was necessary to look at a business as a whole set of operations.