Journal of Economic and Financial Sciences
ISSN: (Online) 2312-2803, (Print) 1995-7076

Tax incentives for funders of small businesses: A fit for crowdfunding?

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Dates:
Received: 28 June 2023
Accepted: 26 Feb. 2024
Published: 10 July 2024

How to cite this article:
Oosthuizen, A. & Swanepoel, A.P., 2024, 'Tax incentives for funders of small businesses: A fit for crowdfunding?', *Journal of Economic and Financial Sciences* 17(1), a903. https://doi.org/10.4102/jef.v17i1.903

Orientation: Internationally, crowdfunding has developed over several years as an alternative funding model for small businesses that would otherwise not be able to qualify for traditional business funding in the form of loans through normal funding channels such as commercial banks.

Research purpose: The objective of the study is to determine whether the *Income Tax Act* of South Africa provides incentives to encourage crowdfunding.

Motivation for the study: Tax policy is considered at a time when there is uncertainty globally about the tax treatment of crowdfunding and when there is no guidance specifically for the South African income tax implications.

Research approach/design and method: A mixed-method approach, which commenced with legal doctrinal research followed by a survey, was applied. The tax implications of funding provided by the crowd (i.e. the public) in South Africa were compared with the tax implications in the United Kingdom and Australia.

Main findings: A tax incentive will encourage funders to provide funding in instances other than donation-based funding that is made from pure generosity. However, existing provisions in the *Income Tax Act* of South Africa that provide incentives to funders of small businesses are not fit for crowdfunding. A single tax credit aligned with international practice is proposed to encourage funders to provide funding to small businesses.

Practical/managerial implications: The findings provide valuable insights for policymakers as they demonstrated that tax incentives encourage funders to provide funding.

Contribution/value-add: This article contributes to the limited research that has been done on crowdfunding in South Africa and provides some of the first empirical results.

Keywords: crowdfunding; crowdsourcing; funding; small businesses; South Africa; tax incentives.

Introduction: Background

Small businesses must often rely on internal funding and funding received from family members as they are not able to provide security to conventional sources of funding such as banks. Once the business is established and makes a profit, the banks are more willing to provide funding because they have collateral to offer. Crowdfunding can bridge this gap and make use of funding received directly from the public (the crowd).

Crowdsourcing is the foundation of the crowdfunding concept (Belleflamme, Lambert & Schwienbacher 2014). According to Kleemann, Voß and Rieder (2008):

> [*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. (p. 6)

Howe (2009:8) contends in his support for crowdsourcing that 'the best person to do the job, is the one that wants the job'. Everyone possesses more potential than what might be expressed in their current economic structure, which crowdsourcing utilises (Howe 2009). With crowdsourcing, only quality is important, and all other factors such as your demographics and qualifications are eliminated (Howe 2009). Crowdfunding connects those with money to those in need, thus levelling the playing field (Howe 2009).

With crowdfunding, projects are promoted on a crowdfunding platform by the different project owners seeking funding. It is then up to funders, who can be any member of the public (i.e. the crowd), to choose a project(s) that they want to fund. Belleflamme et al. (2014:588) define crowdfunding as:

> [*A*]n 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.

There are four main crowdfunding models provided by different crowdfunding platforms on which the projects are highlighted on the Internet. The models are classified based on what is offered in return for the contributions:

- A donation-based crowdfunding model is one in which funders do not expect something in return for the funding provided (Bradford 2012; Li, Wang & Yue 2015).
- A rewards-based crowdfunding model is one in which the funder provides funding but expects something (other than interest and shares) in exchange (Bradford 2012).
- Debt-based crowdfunding is a crowdfunding model in which funders make loans to project creators that are repayable, either at a set interest rate or without interest (Hemer 2011).
- With equity-based crowdfunding, the funder acquires shares in the company that might generate dividend income for the funder (Hemer 2011).

The benefits of crowdfunding are mostly to the project owner (the person receiving the funding) and include access to funding (Agrawal, Catalini & Goldfarb 2013; Belleflamme, Omrani & Peitz 2015; Hemer 2011; Heminway & Hoffman 2011; Howe 2009; Mollick 2014; World Bank 2013), stimulation of the economy (Heminway & Hoffman 2011), testing the market and validate the product or service that they plan to offer (Mollick 2014; World Bank 2013), brainstorming (Bessière & Stéphany 2016; World Bank 2013) and creating a clientele early in the start-up process (Mollick 2014).

Except for material and extrinsic rewards (such as products or a financial return), immaterial and intrinsic motivations also encourage funders to support crowdfunding (Hemer 2011; Li et al. 2015). Intrinsic rewards include the funder being able to identify personally with the subject and goals of the project, providing funding to a project that is socially important or which the funder derives satisfaction from being a member of a specific community and witnessing the success of the funded project, the funder can enjoy the interaction with the team of the project and expand his or her personal network (Hemer 2011).

Internationally, some governments (such as the UK and Australia) 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. 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)

As 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 *Income Tax Act of South Africa No.58 of 1962* (ITA). Most of the existing tax principles were determined before today's technological innovations and expansions and might be outdated. Specific legislation or guidelines, explicitly for crowdfunding transactions, will make the taxation of crowdfunding more efficient, equitable and easier to administer (Battista 2015:144).

Problem statement

Crowdfunding is a novel tool that small businesses and entrepreneurs use to obtain capital from sources other than traditional sources (Mollick 2014). As it is a valuable source of alternative funding for small businesses, it is important that funders are motivated and encouraged to provide such funding to support small businesses and the growth of the economy. The ITA contains provisions to assist small businesses by encouraging funders to supply funding to small businesses. It needs to be determined if these provisions accommodate crowdfunding, providing incentives to the funders to assist small businesses.

Research objective and research methodology

The objective of this study is to determine whether existing provisions in the ITA provide incentives for funders from the crowd to provide funding to small businesses. This study only focuses on the income tax provisions and only from the perspective of the funders of crowdfunding. Given the fact that the research on crowdfunding is still in its infancy, especially from a South African viewpoint, an exploratory mixed-method research design was followed to gather as much research data, from as many diverse sources, as possible. Through doctrinal legal research, relevant legislation and judicial precedents used in South Africa, the UK and Australia are explored and analysed by legal interpretation and comparative assessment. Existing provisions in the ITA are firstly explored to determine whether they accommodate the unique characteristics and benefits of crowdfunding to encourage the public to provide funding. As the United Kingdom (UK) and Australia contain specific incentives to promote crowdfunding, those tax incentives offered in Australia and the UK are thereafter explored as a recommendation to the South African income tax legislation.

A questionnaire was developed to determine whether a tax incentive would have encouraged funders to make contributions to a crowdfunding project. An electronic link to the questionnaire was sent to two Internet-based South African crowdfunding platforms. As both these platforms support donation- and reward-based crowdfunding, they were selected to reach a wider variety of crowdfunders. Other South African platforms such as BackaBuddy only support donation-based crowdfunding. Thundafund added the link to all their outgoing correspondence and Jumpstarter added the link to their online newsletter (25 July 2020). The link was therefore made available to people who have signed up for an account at one of these platforms. Anyone can sign up for an account and you do not have to create a project or make a contribution to an existing project in order to be eligible to sign up. However, as the link is electronically available, it could also have been forwarded to other persons by the account holders. The link to the questionnaire was also made available and shared on the Facebook profile of the researcher. Respondents accessed the questionnaire through the link and completed the questionnaire electronically. Descriptive statistics are applied to interpret the results.

Existing incentives under the *Income Tax Act* of South Africa

As there are no specific provisions in the ITA referring explicitly to crowdfunding, the general deduction section (section 11[a]) is first explored to determine whether funders can claim a deduction for funding provided to crowdfunding projects. Furthermore, section 23(g) of the ITA requires that only money laid out or expended for purposes of trade is deductible. The trade requirement therefore limits the available deduction under section 11(a) significantly and would exclude funding provided by a funder who did not provide it from his or her trade perspective. Other provisions (such as provisions dealing with donations to public benefit organisations, small business funding entities, small business undertakings and venture capital companies) are then explored to determine whether the funder would be able to get a deduction under those sections even though they do not have a trade and do not meet the requirements of the general deduction provision.

General deduction

Expenditure and losses are deductible in terms of section 11(a) read with section 23(g) of the ITA if it was incurred for trade purposes in the production of income. The amount is not deductible if the expenditure or loss is capital in nature. If, for example, contributions were made to a project to advertise the funder's trade, it will be deductible as an expense if it is not of a capital nature. With the rewards model, it can be argued that a payment was made in advance by the funder for the reward offered by the project. This means that the contribution made by the funder might therefore be deductible if the product or service was purchased for purposes of the funder's own trade. The deduction of an advertising expense was, however, denied for a donation made by Pick 'n Pay to a foundation. It was held that Pick 'n Pay did not provide evidence that the donation was made solely for trade purposes (*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)*. The section that prohibited a deduction for dual payments, section 23(g), was thereafter amended to allow the apportionment of an amount used only partly for trade purposes.

It was held in *Warner Lambert SA (Pty) Ltd v Commissioner for SARS 2003 JOL 11098 (SCA)* that social responsibility expenses incurred by the company were incurred in the production of income of the company's trade and were therefore deductible. Such expenses were deemed to be like insurance premiums that were incurred to protect the company's income. It was held that if the company did not incur the social responsibility expenses and lost its subsidiary status, the company might suffer further losses and trade disadvantages.

Similarly, a deduction is allowed for expenses incurred by businesses to attain their Broad-Based Black Economic Empowerment (B-BBEE) scoring if it complies with the requirements of section 11(a). Businesses are encouraged to spend 1% of their net profit after tax annually on enterprise development contributions (South Africa 2003). A business can also make payments to qualified third parties (such as to small business funding entities [SBFE] or incubator entities) to perform the enterprise development on their behalf. Such payments will still be taken into consideration in calculating the B-BBEE score of the business. However, as is discussed below, the ITA does not provide for a deduction for contributions made to an SBFE. Such contributions will only be deductible if they comply with the requirements of section 11(a), read with section 23(g) as discussed above. The Davis Tax Committee (DTC) recommended that the ITA should be amended to make provision for a deduction for all expenditures relating to the support and development of small businesses (Davis Tax Committee 2016).

If it is argued that the contribution was purely gratuitous and nothing is expected in return for the contribution (typically under donation-based crowdfunding), the contribution will not be deductible (unless section 18A applies as discussed here) as it is of a capital nature and not in the production of income (Oosthuizen 2022).

Donations to public benefit organisations

If the contribution is not related to the production of income of the funder's trade, the contribution may qualify as a deduction under section 18A of the ITA if the funding was provided to a project that carries on a public benefit activity and is registered as a public benefit organisation (PBO). Not all crowdfunding projects will qualify for this registration as such activities should be of a benevolent nature, having regard to the needs, interest and wellbeing of the public (Part I of the Ninth Schedule of the ITA). If the activity continued by the PBO for which a contribution is made, does not fall within Part II of the Ninth Schedule, the funder will not qualify for the deduction of section 18A. Paragraph (p) of the Part II of the Ninth Schedule includes:

> [C]ommunity development for poor and needy persons and anti-poverty initiates 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, no such regulations prescribed by the Minister to set out the conditions for paragraph (p) above to apply, could be found. This tax deduction, therefore, cannot be regarded as an incentive to funders of small businesses because the activities that qualify are those typical of a non-profit organisation and not of an entrepreneurial business.

Small business funding entities

Provisions for SBFE in section 30C of the ITA are similar to the provisions applicable to a PBO. Similar to a PBO, the receipts and accruals of an SBFE are exempt from normal tax if they are not derived from any business undertaking or a trading activity (section 10[1][cQ]). The funding received is exempt to the extent that funding is utilised by the SBFE to provide funding to small-, medium- and micro-sized enterprises (SMMEs) on a non-profit basis with an altruistic or philanthropic intent. The funding received from the SBFE by an SMME is also exempt from normal income tax for the SMME (section 10[1][zK]).

If these provisions are applied to crowdfunding, the platform (intermediary who receives the funding from the funders and pay it over to the project owner) can qualify as an SBFE. The funding paid over to the project creator (the SMME) will then be exempted from income tax for the SMME. This is a benefit to the SMME who is then able to use the gross amount received to fund expenses of the business. However, there is not a similar provision in the ITA to allow for a specific tax deduction for the funder for the funding provided to the SBFE. This contrasts with contributions made to a qualifying PBO for which the funder can claim a tax deduction in terms of section 18A as well as for contributions to a venture capital company (see below). The funder of an SBFE will consequently only be able to claim such a contribution as a deduction for income tax purposes if the requirements of sections 11(a) and 23(g), as discussed above, are met. The deduction will be allowed in extremely limited cases such as if it was incurred for trade purposes for advertising or for social responsibility expenses, as discussed above. This SBFE provision can therefore not be regarded as an incentive for funders to encourage crowdfunding for small businesses.

Small business undertakings

Section 37G of the ITA authorises the Minister of Finance to issue regulations to make it easier for natural persons who conduct business through small business undertakings to comply with the provisions of the ITA. However, no such regulations were issued yet.

Venture capital companies

The ITA provides tax incentives for funding provided to a venture capital company (VCC) (section 12J). The section was introduced to assist with the challenge that small- and medium-sized businesses face in accessing equity finance (South African Revenue Services 2012). A VCC provides funding (e.g. angel investor) to several independent small businesses and may not control a company in which it invested (South African National Treasury 2008). The amount expended in purchasing the shares in the VCC is allowed as a tax deduction for the investor (i.e. the funder). 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 assessment in cases where a loan or credit is used to finance the cost of acquisition of the shares. 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 shares (section 12J[3][b] of the ITA).

With equity crowdfunding, however, an investor invests directly (and not through a VCC) into the company that requires funding making the VCC provision not suitable for equity crowdfunding. With equity crowdfunding, the investor will receive shares directly in the business that the investor funds and not via another company. 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.

The Davis Tax Committee (2014) contended that section 12J is not effective as it targets established SMEs and does not promote the growth of micro-businesses in South Africa (Davis Tax Committee 2016). This incentive in section 12J is consequently only available for shares acquired before 01 July 2021. According to the Davis Tax Committee (2016), a separate tax incentive to encourage angel investors to invest in SMEs should be considered.

Lessons from the international experience

The Mirrlees Commission reviewed the UK tax system to (Mirrlees et al. 2011):

> [*I*]dentify 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. (p. v)

This Commission also attempted to ensure that the conclusions were relevant globally (Mirrlees et al. 2011). 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 (Mirrlees et al. 2011). It was submitted that such provisions reduce anti-avoidance provisions to prevent small companies from being established merely to take advantage of a reduced tax rate (Mirrlees et al. 2011).

Tax legislation of the UK and Australia contains specific tax incentives for funders to encourage investment in crowdfunded projects. In addition to incentives for venture capital trusts (like South Africa's VCC, in which you invest through another company rather than directly), the UK has venture capital schemes that offer specific tax breaks to individuals who invest in small businesses. These tax breaks therefore make provision for equity crowdfunding and provide tax incentives to the individual who invests in the small business company. The Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and the Social Investment Tax Relief (SITR) are the venture capital schemes (United Kingdom 2007). 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 exchange. There are two types of relief available: income tax relief and capital gains tax relief.

An investor investing in a SITR or EIS is eligible for an income tax relief calculated as 30% of the amount invested. This relief is increased to 50% for investments in a SEIS. The amount on which the credit is calculated is limited to £1 million (limited to £100 000 for SEIS), and there are no capital gains tax consequences for shares sold after 3 years.

In a study performed by Colahan et al. (2016) to investigate the utilisation and effect of the EIS and VCTs, the income tax relief was either essential (32%) or very important (47%) in deciding where to invest for 79% of the respondents. Some investors who invested primarily for entrepreneurial or philanthropic reasons decisions would not have been influenced by the tax breaks (Colahan et al. 2016). However, they also stated that because of the tax breaks, they were able to invest larger sums (Colahan et al. 2016). According to another study, more investors invested in SEIS-eligible projects after the SEIS was implemented than before the SEIS was implemented (Chen, Lin & Zhang 2018).

The tax incentives in Europe (UK, France, Italy, Spain and Belgium) were compared by Cicchiello, Battaglia and Monferrà (2019). It was determined that the tax incentives most used were up-front tax credits on the amounts invested (Cicchiello et al. 2019). It was contended that the tax incentives for SEIS and EIS, as applied in the UK, were more likely to work in crowdfunding (Cicchiello et al. 2019). However, because of a lack of data, no conclusive evidence could be provided on the effectiveness of the tax incentives (Cicchiello et al. 2019).

The Australian Government committeed to relaxing regulatory requirements to make it easier for small businesses 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).

In Australia, Division 360 of the *Income Tax Assessment Act 1997* contains tax incentives for investors who invest in early-stage innovation companies (ESIC). Section 4-10 of the *Income Tax Assessment Act*, 1997, provides for a tax credit equal to 20% (limited to $200 000 in total for the investor and affiliates of the investor per annum) of the amount paid for the qualifying investment. Any unused amount can be carried forward to the next tax year. Section 360-50 of Income *Tax Assessment Act, 1997* also provides for capital gains tax relief. Capital gains and losses are disregarded for shares that were held for less than 10 years. The investor is only taxed on the capital growth in the market value of the shares from the 10th year onwards. These provisions of the UK and Australia, in contrast to South Africa's VCC provisions, therefore allow investors to invest directly into companies, including private companies, and to receive a lucrative tax benefit for their investment.

Ethical considerations

Ethical clearance to conduct this study was obtained from the University of South Africa College of Accounting Sciences Research Ethics Review Committee (reference no. 2020_CAS_017).

Survey results

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. 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

TABLE 1: Age group of respondents.

Age group (years)	Number of responses	%
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**

TABLE 2: Race of respondents.

Race	Number of responses	%
Black people	15	38.46
Mixed race people	3	7.69
Indian people	2	5.13
White people	19	48.72
Total	**39**	**100**

TABLE 3: Location of respondents.

Province located	Number of responses	%
Eastern Cape	1	2.56
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
Other	2	5.13
Total	**39**	**100**

TABLE 4: Field of occupation of respondents.

Field of occupation	Number of responses	%
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**

TABLE 5: Level of financial literacy of respondents.

Level	Number of responses	%
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**

other questions. Most respondents (68.42%) were in the age group of 40 years or younger. Their responses are reflected in Table 1.

It was important to establish the race of the respondents to determine whether 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 shown in Table 2.

The sample was fully representative of South Africa on a provincial level, as 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 (20.52%), and the Free State and KwaZulu-Natal (with 17.95% each) as indicated in Table 3. As the questionnaire was sent electronically, an option was added for the possibility that someone outside of South Africa might answer the questionnaire. Two respondents (indicated under 'other') were from Nairobi and Nigeria, respectively.

Respondents were required to indicate the main field in which they were currently occupied. Their responses are shown in Table 4.

Most 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, 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.

Respondents were required to indicate their level of expertise in investments and investment decision making. Their responses are indicated in Table 5. 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.

Most respondents (81.58%) indicated that their level of financial literacy regarding investment decisions was intermediate or lower. This 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.

Respondents were asked whether, if they were to assume that they would receive a tax deduction or tax benefit for the amount that they have contributed to the 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 majority indicated that it would not have influenced their decision. The responses are reflected in Table 6.

However, when asked about a random project (meaning any project and not the project that they specifically

TABLE 6: Influence of a possible tax deduction for all respondents.

Response	Number of responses	%
Yes	14	37.84
No	23	62.16
Total	**37**	**100**

TABLE 7: Effect of a tax deduction in relation to a random project.

Response	Number of responses	%
Yes	27	71.05
No	11	28.95
Total	**38**	**100**

TABLE 8: Effect of a tax deduction in relation to only those who contributed.

Response	Number of responses	%
Yes	7	38.89
No	11	61.11
Total	**18**	**100**

TABLE 9: Effect of a tax deduction on a random project, related to only those who had previously contributed to a project.

Response	Number of responses	%
Yes	7	63.64
No	4	36.36
Total	**11**	**100**

contributed to), 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 7. One respondent did not answer the question, but the effect thereof is not material on the results.

Comparable results were obtained when only those who had made contributions to crowdfunding projects (19 respondents of which one did not answer the question) were considered. The responses are indicated in Table 8.

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 9.

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 10. 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. For such responses (where more than one factor was given a rating of 1), the factors were grouped together and are indicated in the shaded areas of Table 10 and Table 11.

The above question was also asked of all respondents, regardless of whether they had contributed in the past. The results are reflected in Table 11.

TABLE 10: Factors that would encourage participants to invest (those who had contributed).

Factors	Number of responses	%
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**

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 a 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. Twelve of the 39 respondents also indicated that a financial benefit or the product offered would encourage them (alone and together with other benefits).

It was determined in the review of the international literature that local funders (funders within 50 km 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). 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 as they know the investor and the information asymmetry is therefore assumed to be minimal (Agrawal et al. 2011). 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 et al. 2011). 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 et al. 2011). It was concluded that funding is therefore not geographically constrained and is

TABLE 11: Factors that would encourage participants to invest.

Factors	Number of responses	%
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 and 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**

independent of geographic distance between the funder and project creator (Agrawal et al. 2011). The data displayed in Table 11 support these arguments as 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.

Based on the results of the survey instrument, 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.

Proposed incentives for funders of crowdfunding in South Africa

The ITA contains two provisions, the SBFE and the VCC provision, which are aimed at assisting small businesses. However, these provisions are not fit for crowdfunding and do not provide incentives for the funders making the contributions. The provisions of the VCC as well as the small business funding entities do not allow a funder to invest directly into the business that requires the funding but through an intermediary. It is therefore proposed that the current sections dealing with SBFEs should be amended to encourage support for small businesses through crowdfunding. The maxims of a good tax system (simplicity, transparency, certainty, equity and fairness) will be promoted if there is one section with the same requirements and the same incentive to all funders of small businesses through crowdfunding.

It is proposed that the current SBFE provision should be expanded to allow individual projects to register as a new 'small business funded entity' (SBF). Funding received by each SBF should then be exempt, like the current exemption for an SBFE. By exempting the funding, the SBF can utilise the money to grow the business. It will furthermore encourage business owners to make use of this provision and to register as an SBF. This registration requirement would limit abuse of the system and would assist in regulating the crowdfunding industry. Requiring registration is an additional regulatory tool to ensure that only legitimate companies are created and will provide an additional paper trail and compliance monitoring mechanism that mitigates the risk of fraudulent platforms and consequent financial losses to funders.

Similar to the UK and Australia where evidence shows the effectiveness of a tax credit, it is proposed that a single tax credit (calculated as the difference between the funding provided and the reward received (if any) should be introduced to encourage investment in small businesses using crowdfunding. This will promote equity and fairness in the sense that an incentive is provided to any taxpayer who supports small businesses and not only to persons trading who receive a section 11(a) deduction for social investment or enterprise development contributions. This is also in support of the recommendations of the Davis Tax Committee and Mirrlees Committee. 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%. The interpretation of the ITA will be simplified with the introduction of a single tax credit, taking into consideration the various demographics of the population of South Africa as well as the fact that crowdfunding is still in its infancy in South Africa. It is proposed that credit should not be at the maximum of 50% provided for the UK but should also be sufficient to encourage crowdfunding. A percentage in-between the 50% of the UK and 20% of Australia, being 30% of the investment amount (30% of the difference between the funding provided and the reward received [if any] in return) is therefore proposed and are line with the minimum percentage applicable in the UK.

For debt-based crowdfunding, the credit will be based on the difference between the interest earned and the interest that would have been earned had the official rate of interest been charged. This supports the recommendation of the Mirrlees Commission that a deduction should be allowed each year for the opportunity cost of capital previously saved or invested (Mirrlees et al. 2011).

The proposed SBF tax credit should also apply to equity crowdfunding. It is, however, also proposed that the proposed SBF tax credit and the current section 12J should be applied on a cumulative basis to prevent double relief. The UK and Australia placed caps 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 or retail investors, allowing a lesser amount for investors who are not sophisticated investors. It is finally proposed that capital gains tax relief is provided on the disposal of the shares of equity crowdfunding, like the relief provided for shares in a VCC.

Conclusion

From the results from the literature as well as the survey, it appears that a tax incentive from crowdfunding, provided for reasons other than pure generosity, will encourage funders to contribute. Existing tax legislation does, however, not provide incentives to all funders of crowdfunding for supporting small businesses through crowdfunding. A new tax credit is proposed for South Africa to encourage funders of the crowd to support small businesses in filling the financing gap and to grow the economy. Internationally, crowdfunding has developed over several years as an alternative funding model for small businesses that would otherwise not be able to qualify for traditional business funding in the form of loans through the normal funding channels such as commercial banks. Thus, if tax incentives are available for individuals or companies investing in a crowdfunding project or venture in support of small businesses, it will stimulate the South African economy and grow the tax base for the South African Revenue Services. This research can be supplemented by further research on the effect of such a credit on the behaviour of funders in South Africa.

Acknowledgements

This article is partially based on the author's thesis entitled ' A tax framework for crowdfunding in South Africa' towards the degree of Doctor of philosophy in Accounting Science in Taxation at the University of South Africa, South Africa on 31 January 2021, with supervisor Andries P. Swanepoel. It is available here: https://hdl.handle.net/10500/28502.

Competing interests

The authors declare that they have no financial or personal relationships that may have inappropriately influenced them in writing this article.

Authors' contributions

A.O. and A.P.S. contributed equally to this research article.

Funding information

This research received no specific grant from any funding agency in the public, commercial or not-for-profit sectors.

Data availability

Derived data supporting the findings of this study are available from the corresponding author A.O., on request.

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