Small businesses often struggle to get funding due to the lack of collateral. Alternative funding, such as crowdfunding, became increasingly popular after the financial crisis in 2008. The objective of the study was to determine if funding, received by businesses from alternative sources of funding, is subject to income tax in South Africa. A legal doctrinal research approach was applied by reviewing available literature, tax legislation and relevant case law in South Africa, the United States of America, United Kingdom and Australia. It was determined that existing income tax provisions do not specifically refer to crowdfunding and principles laid down in decided tax case law need to be considered to determine if the amount received, is a gift made out of pure generosity. The amount is likely not to fall within the ambit of ‘gross income’ of the project owner if the donor expected nothing in return and the funding was not used by the project owner to supplement trading activities. With reward-based crowdfunding, the funding is highly likely to fall within the ambit of gross income since something is expected in return for the funding provided to the business. It is imperative that South Africa issues application guidance to reflect the intended meaning of the legislature regarding the tax treatment of funding received by project owners.

**Contribution:** This article demonstrated that it is imperative that South Africa issues application guidance to reflect the intended meaning of the legislature regarding the tax treatment of funding received by project owners.

**Keywords:** alternative funding; crowdfunding; donation-based crowdfunding; funding; reward-based crowdfunding; tax.

**Introduction and background**

Small businesses struggle to get funding (Bradford 2012; Cosh, Cumming & Hughes 2009; Shadrach-Razzino, Chetty & Pick 2017). It is also no secret that one of the reasons for the difficulty to get funding from traditional sources (such as banks), is the lack of collateral that new and upcoming businesses often suffer (Cosh et al. 2009; Lee, Sameen & Cowling 2015). Many are forced to turn to other sources of funding such as crowdfunding.

The principle of crowdfunding is not new. In essence, any donation to a cause can be seen as funding provided by the crowd (i.e. the public). However, the Internet has created an opportunity for an intermediary platform to facilitate this process and to make it open to any member of the public to provide funding to a project (Belleflamme, Lambert & Schwienbacher 2014). Crowdfunding is therefore defined as:

\[
\text{[4] In open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or for some form of reward to support initiatives for specific purposes. (Belleflamme et al. 2014:588)}
\]

With crowdfunding, the project owner creates the project for which funding is required on the crowdfunding platform. Funders are then requested to provide funding. The funding amounts are deposited into the bank account given on the platform and are transferred to the owner of the project once the stated goal amount has been reached (depending on the terms and conditions explained on the platform). There are four main crowdfunding models which are classified according to what the funder receives in exchange for funding provided: donation-, reward-, debt- and equity-based crowdfunding. With donation-based crowdfunding, the donations are paid to the project owner without providing anything in return to the funders (other than maybe recognition) (Bradford 2012; Li, Wang & Yue 2015). With reward-based crowdfunding, the project owner provides something (such as the product that they want to sell) in return for the funding received, other than interest (which is debt-based crowdfunding) or shares (which is equity-based...
crowdfunding) (Bradford 2012). According to Belleflamme, Omrani and Peitz (2015) and Dietz (2013), it is not always easy to distinguish between donation- and reward-based crowdfunding since simply mentioning the funder’s name can be seen as a reward (advertising).

Debt-based crowdfunding is the provision of a loan by the different funders so the funders receive interest (if charged at all) on the loan amounts (Hemer 2011). With equity-based crowdfunding, the funders receive a combination of shares and voting rights and consequently dividends on their investment (Hemer 2011). In contrast to a bank where you do not have control over to whom your savings are loaned, the decision as to whom you want to donate or provide money to, lies solely with the funder.

**Problem statement**

Although the concept of crowdfunding through an internet platform is relatively new, crowdfunding is growing. In South Africa, BackaBuddy (a donation-based crowdfunding platform) raised R162 002 743 as at 21 April 2020. This increased to R348 406 228 as at 22 August 2022 which is an increase of 115%. Similarly, during this period the funding raised by Jumpstarter (a reward-based crowdfunding platform) increased from R581 420 to R1 198 633 (with 106%). Thundafund (a reward-based crowdfunding platform that originated in South Africa but moved their administrative functions to Kenya) increased from $3240 657 to $5 040 657 (with 55%). Although many researchers focus on the advantages, disadvantages and psychological aspects of crowdfunding, one aspect that is often ignored, is the tax implications of such funding received. Concerns have been raised globally about the Uncertainty of these tax implications (Brandon 2015; Dietrich & Amrein 2016; Rudarakanchana 2013). Furthermore, since any person (regardless of their education, background and demographics) can create a project that needs funding on the platform, the project owner might not even be aware of, or consider, the tax implications. This could lead to adverse tax implications such as less after-tax funding, as well as penalties and interest imposed by tax legislation for non-compliance. This can have far-reaching consequences, which might lead to unexpected tax consequences for the taxpayer and a loss to the fiscus if taxpayers do not comply with income tax legislation.

**Research objective and research methodology**

The objective of the study is to determine if funding received from alternative sources of funding, such as crowdfunding, is subject to income tax in South Africa for the project owner (i.e. the business) who received the funding. Applicable taxes include, amongst others, income tax, capital gains tax and value-added tax. However, this study focuses only on the income tax consequences. The study is therefore limited to only the provisions of the *Income Tax Act* 58 of 1962 of South Africa (hereafter referred to as the ITA) (South Africa 1962) dealing with funding received and not on other tax legislation, such as value-added tax (VAT). Donations tax is furthermore not addressed in detail since it has implications to the funder and not the project owner. Through applying a doctrinal legal research approach, the South African income tax implications and case law principles were firstly explored. This was then extended to explore principles applied in the United States of America (USA), the United Kingdom (UK) and Australia for comparative perspectives to provide additional weight to the recommendations for law reform (Hutchinson 2012).

Since crowdfunding makes use of the Internet which eliminates boundaries as to who can participate, it was deemed appropriate to also investigate the income tax implications in other countries. The reason for selecting the specific countries is that the USA is seen as the leader of the market of crowdfunding business (De Beer 2014). The USA-based crowdfunding platform Kickstarter is mostly referred to in research (such as Dietz 2013; Ganatra 2016; Koch & Siering 2015; Rudarakanchana 2013) whereas the UK is one of the first countries to provide specific tax incentives for crowdfunding. Furthermore, South African income tax law has much in common with Australia, in terms of the origins of its tax law, being reliant on legislation from New South Wales at that time (Harris 2016). Although the laws of these countries are not enforceable in South Africa, the income tax treatment of crowdfunding in these jurisdictions has persuasive value.

**The South African income tax implications**

Funding received by the owner of the project, is taxable in South Africa if the amount falls within the definition of gross income in section 1 of the ITA. Gross income in the case of a resident is the total amount, in cash or otherwise, received by, or accrued to, or in favour of such a resident. A non-resident is taxed in South Africa only if such a amount was from a South African source. It is not gross income if the amount is of a capital nature. Furthermore, the amount received might be specifically exempt from being subject to tax.

It follows that, if the project owner is for example a public benefit organisation, or a small business funding entity, the funding received will not be taxed if it complies with the requirements of being exempt as determined in section 10(1)(cN) and section 10(1)(cQ) respectively. However, with crowdfunding that is being used by entrepreneurs to create businesses, the project owners will not be a qualifying exempt entity since the entrepreneurial entities will not comply with the provisions contained in sections 30(1) and 30C(1) to be qualifying entities. The funding received will, therefore, only be excluded from the ambit of gross income if the receipts are of a capital nature. If the funding is received from the disposal of an asset by the project owner, there might be consequences regarding capital gains tax. However, this is unlikely since funding is normally not received from the crowd because of the disposal of an asset by the project owner. With debt-based crowdfunding, the amounts received by the project owner
are repayable and are therefore not the disposal of an asset. Similarly with equity-based crowdfunding, the funding is provided through purchasing shares in the company which are of a capital nature and not a disposal for capital gains purposes (in terms of paragraph 11(2)(b) of the Eighth Schedule of the ITA). The main uncertainty is therefore with the donation- and reward-based crowdfunding models in order to determine if the funding received is of a capital nature or not.

The ITA does not contain a specific provision stating that a donation is excluded from gross income since it is always of a capital nature. It is therefore important to explore principles laid down in decided case law. Limited case law is available in South Africa that applies to the tax implications of funding received, since most case law, dealing with whether a receipt is of a capital nature or not, dealt with the proceeds from the disposal of an underlying asset.

It was held in Commissioner for Inland Revenue v Lunnon [1924] A.D. 94; 1 SATC 7 that a gratuity that was paid to a former director to compensate him for services rendered in previous years on the board of directors (when the compensation that was paid during those years was not in line with the value of his services rendered), was of a capital nature and not taxable as gross income. The court stated that:

Now this gift had none of the attributes of income; it was not produced by the respondent’s capital, nor was it earned by his labour or his wits or in any other way. There was no recurrence about it. What was sometimes called annuality was not necessarily a decisive test as to whether a receipt or accrual was capital or income; but it was an important element to be taken into consideration. And in the present instance it was wholly absent. This grant was a fortuitous addition to the capital of the recipient, and it appeared to His Lordship to be of a capital nature, like any ordinary donation or legacy. (Lunnon [1924] A.D. 94 at 9)

The amount received was therefore not taxed since it was determined that it was not produced through services rendered (his labour) and was fortuitous. The gross income definition was subsequently amended with the addition of a specific inclusion provision (paragraph [c]) which determines that an amount constitutes gross income if it was received or accrued in respect of services rendered. With reference to this addition to the gross income definition of the ITA, the court stated in ITC 599 [1945] 14 SATC 272(U) at 273 that:

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

It is therefore evident that the receipt will be of a capital nature if the donation was made out of free will and the donor was not under an obligation to pay the amount. The court found similarly in ITC 1545 [1992] 54 SATC 464(C) at 476 that ‘a payment or disposal of property which is motivated by self-interest or some reason other than “liberality and generosity” is not “gratuitous” and is therefore not a donation’. It therefore follows by applying the principle in ITC 599 [1945] already mentioned that, if funding is received from a donor who has an obligation to pay, it is not a receipt of a capital in nature.

When a donation is made solely out of pure generosity for charitable purposes, it is clear that the funding will not be included in the definition of gross income. This is because the donor was under no obligation to pay the amount and the funder is under no obligation to provide something in return. The amount was paid out of pure generosity. However, if a donation is made to a business which requested funding in order to fund business operations or to be utilised for the creation of a product to be sold, it is more complex. If a reward is offered in return for the funding, the funder provides the funding in anticipation of the reward. The funding is therefore not provided out of pure generosity and the project owner is under an obligation to provide the reward. It can therefore be said that the funding provided in such a case is motivated by self-interest of the funder (such as the acquisition of the product [the reward] or some reason other than pure and sole generosity as referred to in ITC 154 [1992] mentioned before).

Furthermore, since the project owner is a business, which will utilise the funding to fund its business operations, it will have a profit-motive. It was held in Commissioner for Inland Revenue v Pick ‘n Pay Employee Share Scheme Purchase Trust [1992] 54 SATC 271(A) that whether a business was operated with the intention of producing a profit, determined if the proceeds from operations qualified as revenue. Additionally, it was determined in that case that receipts that were entirely fortuitous and not anticipated or worked for, did not qualify as receipts of a revenue kind and did not meet the criteria for gross income. When a business uses reward-based crowdfunding, a reward (whether a product, service, or a marketing opportunity for the funder) is received by the funder for funding provided to the project owner. With many such projects, the funding provided is merely a prepayment for the acquisition of the ultimate product that is being created by the project owner and for which funding is requested. The funding is therefore used by the project owner to create the underlying trading stock for the business. It will consequently be more difficult to argue that such funding received was of a capital nature and is therefore not subject to tax for the project owner who received the funds.

**International comparison**

It was determined that the income tax legislation in the USA, UK and Australia also do not contain specific, explicit sections dealing with the tax consequences of the receipt of funding from crowdfunding by the project owner. Tax incentives are available in the UK and Australia for funders of debt- and equity crowdfunding. The focus of this study is, however, on the receipt of funding by the project owner. Such funding received are also taxed based on existing principles laid down by case-law in the USA, UK and Australia. Case law
and other principles were investigated to provide further guidance in these countries.

**United States**

IRC §102(a) of the Internal Revenue Code (IRC) (USA 1986) determines that the value of property acquired by gift, bequest, devise, or inheritance is not gross income. The court case of Commissioner of Internal Revenue v Glenshaw Glass Co. [1955] 348 U.S. 426, is frequently cited and provides that income is ‘undeniable accessions to wealth … over which the taxpayers have complete dominion’. Since the definition is very broad, it is possible that funding received through crowdfunding might be taxed, depending on the type of crowdfunding transaction. It follows that, if the funding provided is classified as a gift (i.e. a donation) as determined in IRC §102(a), the amount so received, is not gross income. It is therefore paramount to determine if the amount received is a gift or not.

Similar to the principle laid down in the South African case ITC 599[1945] referred to (that is if there is a obligation to make the payment), it was held in Bogardus v Commissioner of Internal Revenue, [1937] 302 U.S. 34. at 41 that it is not a gift if the payment was made from the ‘constraining force of any moral or legal duty’. However, it was held in Old Colony Trust Company et al. v Commissioner of Internal Revenue, [1929] 279 U.S. 716 that, even if there is not a moral or legal requirement for a person to make a payment, it does not mean it is a gift:

A claim that it is a gift presents the sole and simple question whether its designation as such is genuine or fictitious – that is to say, whether, though called a gift, it is in reality compensation. (Bogardus v. Commissioner of Internal Revenue [1937] at 40)

Other factors therefore also need to be considered. If the payment was not made for services rendered, but made ‘out of affection, respect, admiration, charity or like impulses’, it is a gift (Robertson v United States [1952] 343 U.S. 711 at 714). A gift is proceeds from a ‘detached and disinterested generosity’ (Commissioner of Internal Revenue v LeBue, [1956] 351 U.S. 243 at 246.)

Based on the above principles, it is again evident that it will be very difficult to argue that funding received through reward-based crowdfunding will be a gift since something is received in return for the funding provided. It was held in Bogardus v Commissioner of Internal Revenue [1937] at 45 that ‘What controls is the intention with which payment, however voluntary, has been made’. It was determined that it is not a gift if the payment was made because of the ‘incentive of an anticipated benefit’ of an economic nature (Bogardus v Commissioner of Internal Revenue [1937] at 41) and ‘where the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it’ (Robertson v United States [1952] at 714).

It follows that, similar to in South Africa, an amount will fall within the ambit of gross income if something (such as a product or a service) was received in return for the funding provided. Through studying the USA platform Kickstarter, Dietz (2013) determined that the platform accommodates both donations and/or rewards-based crowdfunding. This hybrid model complicates differentiation between what is a gift and what is a sale. Project owners may receive donations that are taxable (if viewed as regular sales transactions) or contributions that are viewed as non-taxable gifts (Dietz 2013). Gifts will qualify for the gift exclusion in IRC §102(a). To provide some guidance, the IRS issued Information Letter 2016-0036 stating that:

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

These principles are in alignment with the discussion of South African income tax principles mentioned when it was determined that funding received from debt-based and equity-based crowdfunding is not included in gross income. Where funding is received in anticipation of a reward to be provided to the funder, the funding is not a donation and is more likely to fall within the ambit of gross income.

**United Kingdom**

In terms of the Income Tax (Trading and Other Income) Act 2005, profits received or accrued from trading is subject to income tax (Part 2 Chapter 1, section 5 and section 8) (United Kingdom 2005). The question of whether a voluntary receipt was a trading receipt and taxable, was the subject in numerous judicial cases in the UK. It was held that a gift was not a trading receipt if it ‘was wholly unexpected and unsolicited’, ‘was made after the business connection had ceased’, ‘was in recognition for past services rendered… though not because those past services were considered to have been inadequately remunerated’, ‘was made as consolation for the fact that the services were no longer to be performed’, or if there was ‘no suggestion that at a future date the business connection might be renewed’ (in Simpson (Inspector of Taxes) v Reynolds & Co (Insurances) Ltd CA, [1975] 1 W.L.R. 617 at 619 (confirmed later in Walker (Inspector of Taxes) v Carnaby, Harrower, Barham & Pykett, [1970] 1 All ER 502). In McGowan (Inspector of Taxes) v Brown and Another, [1977] 1 W.L.R. 1403 the court determined that even if the payment was voluntary, it is taxable if it was earned (i.e. work was done in exchange for the gift, creating a moral or legal obligation to pay).

It was determined in Commissioner of Inland Revenue v Falkirk Ice Rink Ltd. [1975] STC 434 that, given that the donation received, was utilised to boost the ice rink club’s trading revenue and allow the business to carry on its operations, the donation was considered a trading receipt. In Murray (Inspector of Taxes) v Goodness CA, [1977] 1 W.L.R. 499 (1978) it was noted that the decision to tax a receipt should be made based on the recipient’s intentions, not the payer’s.

Based on the aforementioned guidelines, which state that the recipient’s motivation should be taken into account, it
would seem that funding given voluntarily to a project owner may be subject to taxation as income when received in a business capacity, because the money is used to finance commercial activities.

Another issue is concerned with at what time the funding received should be taxed. In Lunar Missions Ltd [2018] TC 06286, the court had to determine the time of supply for VAT purposes. Whether the monies were liable to VAT upon receipt of payment, was the question at hand. Since it was unknown at the time the money was received, what (if anything) would be supplied, it was decided that the funds received did not constitute prepayments. Whether something would be supplied depended on whether or not the funding goal was achieved. It was decided that the funders were supplied with single-purpose vouchers that awarded them the right to receive a single type of service. The time of supply for VAT purposes was determined to be when the vouchers were issued and not when they were redeemed, since they were classified as single-purpose face-value vouchers.

Despite the fact that VAT is not included in the scope of this study, the findings of the previous decided case provide guidance as to when an amount might become subject to income tax for the project owner. It might be argued that the funding received from reward-based crowdfunding is not subject to income tax until the funding goal is achieved. For income tax purposes, a sale does not occur until the funding goal is achieved and therefore no amount is received or accrued in terms of the gross income definition. If the funding is only made available to the project owner by the crowdfunding platform once the funding goal is achieved, the project owner cannot be said to have received the funding before then, for his or her own benefit (as referred to in Geldenhuys v Commissioner for Inland Revenue [1947] (3) SA 256 [C] for purposes of the ITA of South Africa). This does not indicate that the money will not be subject to tax, as shown by the court cases mentioned before when it must be further determined whether the amount is of a capital nature or not.

Australia

Chapter 1 Part 13 Section 6–1 of Division 6 of the Income Tax Assessment Act 1997 of Australia determines that income is subject to tax if it is ‘assessable income’ (Australian Government 1997). Assessable income comprises ordinary income (section 6–5) and statutory income (section 6–10) (Australian Government 1997).

A gift is normally of a capital nature and therefore not assessable income. However, if there is a link between the activities of the taxpayer and the gift, it will be income if the gift is in a relevant sense a product of the activities (Scott v Federal Commissioner of Taxation [1966] 117 CLR 514; Hayes v Federal Commissioner of Taxation [1956] 96 CLR 55, 56). Funding received, can therefore be assessable income if it can be related and linked to the business activities of the person that received the funding. This is applicable when the funding received from the crowd is being used by businesses as discussed above.

It was held in Federal Commissioner of Taxation v Montgomery [1999] 198 CLR 639 that:

[Income is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on a business are mostly (but not always) income.

There are four positive characteristics of income as expressed in decided in case law:

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 or carrying on a business. (Martin & O'Connell 2018:18)

Conclusion

To ascertain the tax repercussions of donation- and reward-based crowdfunding in South Africa, the USA, UK and Australia, existing income tax law provisions and principles laid down by the courts should be applied. Within the current income tax legislation of the selected countries, it was evident that funding received, will be subject to tax unless it is of a capital nature, being a donation or a gift. Since what constitutes a donation or a gift is not conclusively defined, numerous court cases have provided principles that need to be considered. The main issue with donation-based crowdfunding is to determine if the funding was provided to the project owner without expecting anything in return. If something was expected in return, it appears that the funding received might not be regarded as a receipt of a capital nature.

Furthermore, if there is a connection between the funding and the taxpayer’s business activities, it appears that the income is likely to be of a revenue nature. This will be the case when the funding received from donation- and reward-based crowdfunding is used to supplement trading revenue and/or to fund business activities.

By being subject to income tax, the available funding to be used by the project owner (the business) is minimised. This is in contradiction with the South African government’s aim to assist small businesses. Provisions dealing with small business funding entities, as well as venture capital companies (VCCs) were enacted to promote the creation of small business. However, these provisions predate the rise in popularity of crowdfunding and are not applicable to it. Crowdfunding democratises access to investments through allowing any person (regardless of their demographics etc.) to invest directly in an upcoming business and not through another entity, which is the case with small business funding entities and VCCs.

Although most of the principles discussed in this article are in essence the same in all countries, case law decided in one country, is not law in another country. Uncertainty about the tax implications of crowdfunding is increased with limited available case law in South Africa on funding received (and none dealing specifically with crowdfunding). It is imperative that application
guidance is issued by South Africa to reflect the intended meaning of the legislature regarding the tax treatment of funding received by project owners. Further research is also needed on other tax consequences of crowdfunding, such as the VAT, as well as on the tax implications for the funder.

Acknowledgements
Competing interests
The author has declared that no competing interest exists.

Author’s contributions
I declare that I am the sole author of this research article.

Ethical considerations
This article followed all ethical standards for research without direct contact with human or animal subjects.

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

Data availability
Data sharing is not applicable to this article as no new data were created or analysed in this study.

Disclaimer
The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of any affiliated agency of the author.

References
Bakabuddy, n.d., viewed 22 August 2022, from https://www.backabuddy.co.za/.
Bogardus v Commissioner of Internal Revenue, [1937] 302 U.S. 34.
Backabuddy, n.d., viewed 22 August 2022, from https://www.backabuddy.co.za/.
Geldenhuys v Commissioner for Inland Revenue, [1947] (3) SA 256(C).
Hayes v Federal Commissioner of Taxation, [1956] 96 CLR 47.