

How CRA taxes crowdfunding in Canada

By **David Rotfleisch**

Law360 Canada (February 7, 2024, 11:01 AM EST) -- Crowdfunding, as the name suggests, is a method of collecting funds from many people. Sites like Kickstarter, Kiva, IndieGoGo, and Microventures have recently brought attention to this practice.

Crowdfunding is not new; only the technology empowering crowdfunding is new.

During the Second World War, Canada, in effect, crowdfunded its military by issuing war bonds. The 19th century French philosopher Auguste Comte famously raised funds for his future works by soliciting pre-orders from Parisians. In 1885, a New York newspaper collected donations of \$100,000 from more than 160,000 readers. This money was used to finance the Statue of Liberty's pedestal.



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Depending on the crowdfunding model, funds raised through a crowdfunding campaign may be treated as revenue, gifts, loans, or equity contributions (or a combination) from a Canadian tax point of view. So, the income tax implications of the funds raised will vary depending on the crowdfunding model.

Perhaps the most popular crowdfunding model, reward-based models involve raising small amounts of money from a large number of donors to fund a particular company or product. In return, contributors receive compensation as incentives. For example, contributors may receive early versions of the product or exclusive promotional items such as T-shirts. However, participants will not have any equity in the project or company.

CRA's policy on remuneration-based crowdfunding model

In 2013, the Canada Revenue Agency (CRA) released a document explaining its position on the income tax implications of the remuneration-based crowdfunding model (2013-0484941E5).

The CRA generally considers funds received on an ex-gratia basis through crowdfunding to be business income. As always, the Canada Revenue Agency allows fundraisers to claim deductions for expenses incurred to generate business income:

- In our view, amounts received by a taxpayer from crowdfunding activities would generally be included as income from business operations.
- Whether a particular expense is deductible is a question of fact.

Expenses related to crowdfunding activities incurred by the taxpayer for the purpose of earning or generating income from the business may be deductible.

In 2015, the CRA issued a follow-up document stating that funds raised for product development are business income unless the funds can be proven to be a loan or equity investment (2015-0579031I7):

- Suppose a company uses crowdfunding as a method of raising funds for new product development, and donors receive no equity. Amounts received by a company are included in revenue pursuant to Tax Act Article 9(1).

The CRA has not yet issued guidance on the GST/HST implications of fee-based crowdfunding. Both of the above documents were issued by the CRA's Income Tax Rulings Directorate.

GST/HST obligations still apply to crowdfunding

CRA said in a 2013 document that it forwarded questions to the GST/HST Rulings Directorate regarding the GST/HST implications of the remuneration-based model. To date, it has not heard anything from the GST/HST Rulings Directorate on this issue.

However, this does not relieve a taxpayer of the obligation to register, collect, and remit GST/HST if required by the excise tax law.

CRA's tax policy on donation-based crowdfunding

In donation-based crowdfunding, fundraising campaigns solicit donations for altruistic purposes.

For example, a GoFundMe account can be used to raise money to help a sick child attend a Britney Spears concert or to support a family who lost their house in a fire. Fundraisers who use a donation-based model may not be required to report the funds they receive as income.

These funds are more likely to be gifts, as those who donate money for a stated purpose are unlikely to receive anything of value in return. The recipient of a gift does not have to report the gift as taxable income unless it comes from an employer.

Employer gifts generally constitute taxable employee benefits if the gift exceeds \$500.

On the other hand, donors should not expect a tax deduction for their donations unless they donate to a crowdfunding campaign launched by a registered Canadian charity, such as a hurricane or earthquake relief fund sponsored by the Red Cross.

CRA's tax guidance on debt-based crowdfunding

In debt-based crowdfunding, borrowers apply for loans online. An automated system checks and

validates the application. This system also determines the credit risk and interest rate of the borrower.

Loans are made from investors who purchase securities in funds that make loans to individual borrowers. Investors receive interest on their loans. The system operator receives a service fee calculated as a percentage of the amount borrowed.

Popular debt-based crowdfunding platforms include Zopa, Lending Club, and Prosper.

The Canada Revenue Agency has not issued an official position on taxing this debt-based crowdfunding model. But the tax rules that apply to debt should apply. For example, investors must report interest income as capital income. And if the borrower borrows funds that constitute the underlying loan to generate business profits or capital gains, he or she is entitled to deduct interest payments.

CRA's tax guidance on equity-based crowdfunding

In equity-based crowdfunding, funders offer equity in a company in exchange for an investment. For example, a company can post an offering of its stock on a crowdfunding website.

Although the CRA does not specifically address equity-based crowdfunding, Canada's *Income Tax Act* already addresses the tax implications of capital contributions.

The Income Tax Act provides various rollover regulations that effectively make capital contributions a tax-free event. These rules allow investors to bring capital assets into the company on a cost basis. In return, the recipient inherits the same tax characteristics of the property as it was when it was in the hands of the investor. Therefore, the investor receives no taxable gain from the transfer of the asset to the company, and the recipient's tax cost of acquiring the asset is equal to the asset's tax cost to the investor.

And the same is true if a person makes a cash investment rather than contributing capital assets. This investment remains a tax-free transaction. The recipient does not have to report the mutual fund as income, and the investor does not receive a taxable gain because the cash is not a capital asset. Subsequent disposition of the investment results in capital gains or losses.

Gap between crowdfunding, cryptocurrencies and tax

Tax law generally still needs to catch up with technology, notably with cryptocurrencies and crowdfunding.

Web-based crowdfunding platforms increase flexibility for users, including hybrid crowdfunding models. Lawmakers may therefore adopt new rules that result in different outcomes than traditional transactions.

And courts may be persuaded that the rules that apply to traditional investment transactions should be applied differently in the crowdfunding context.

The result is uncertainty for both fundraisers and donors.

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