

Update

Crowdfunding Takes Centre Stage in Newly Released Documents from the CSA and CRA

On May 14, 2015, the Canadian Securities Administrators (CSA) published [Multilateral CSA Notice 45-316 – Start-Up Crowdfunding Registration and Prospectus Exemptions](#) (the CSA Notice) announcing the adoption of registration and prospectus exemptions (the Start-Up Crowdfunding Exemptions) by the securities regulatory authorities of British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (the participating jurisdictions). The Start-Up Crowdfunding Exemptions permit a company to raise start-up capital through the sale of its securities to the public through a non-registered online crowdfunding portal (commonly referred to as equity crowdfunding).

On a related note, in April 2015, the Canada Revenue Agency (CRA) provided comments concerning its approach to crowdfunding as a method of financing and the associated income tax implications under the *Income Tax Act* (Canada) (the Act).

This Osler Update briefly outlines the substantive elements of the newly adopted Start-Up Crowdfunding Exemptions. In addition, the CRA's recently published position in CRA document no. 2015-0579031I7 – Crowdfunding (April 1, 2015) is also discussed.

What is Crowdfunding?

Crowdfunding is an innovative way to fund a project through the pooling of small, individual contributions. To connect capital seekers and capital contributors, crowdfunding uses the Internet and, more particularly, social media networks. There are essentially three principal variants of crowdfunding:

- the donation model – donors provide money to fund a specific financing goal with nothing pledged in return except a promise to complete the project;
- the rewards model – funders make a monetary contribution to a project, sometimes a company, in exchange for a non-financial reward of some sort, such as being identified publicly as a supporter or a T-shirt; and

- the investment/equity model – investors provide money in exchange for an interest in the profits of the business or an equity stake in the company that they are helping to fund (i.e., equity crowdfunding).

We have provided a more detailed overview of the principal variants of crowdfunding in a previous [Osler Update](#).

Background to the Start-Up Crowdfunding Exemptions

Equity crowdfunding enthusiasts in Canada have been eagerly awaiting regulatory action since March 20, 2014 when the CSA published a [notice](#) for publication and request for public comment on two proposed prospectus exemptions relating to equity crowdfunding – draft [Regulation 45-108 respecting Crowdfunding](#) (such draft instrument being titled in Ontario as Multilateral Instrument 45-108 – *Crowdfunding*, together 45-108) and the draft [Blanket Orders on the Start-Up Crowdfunding Prospectus and Registration Exemption](#) (the draft version of the Start-Up Crowdfunding Exemptions).

The main differences between 45-108 and the Start-Up Crowdfunding Exemptions are that (i) the proposed exemptions under 45-108 would be available to both reporting issuers and non-reporting issuers, unlike the exemption under the Start-Up Crowdfunding Exemptions which is available to non-reporting issuers only, (ii) 45-108 provides a higher offering limit (up to \$1.5 million per year as opposed to \$500,000 under the Start-Up Crowdfunding Exemptions), (iii) 45-108 requires that all investments be made through a registered crowdfunding portal, unlike the Start-Up Crowdfunding Exemptions which provide a registration exemption for crowdfunding portals, and (iv) 45-108 requires that issuers comply with certain ongoing disclosure obligations while the Start-Up Crowdfunding Exemptions do not provide for any formal ongoing disclosure requirements. We have provided a more detailed comparison of 45-108 and the Start-Up Crowdfunding Exemptions (as initially proposed) in a previous [Osler Update](#).

Based on the feedback received from market participants during the comment period, the Start-Up Crowdfunding Exemptions have been implemented by each of the participating jurisdictions by way of substantially harmonized blanket orders which will remain in force for a period of five years, expiring on May 13, 2020. Notably absent from the list of participating jurisdictions is Ontario. Subsequent to the publishing of the CSA Notice, a spokesperson from the Ontario Securities Commission (OSC) was [quoted](#) as stating that the lack of a registration requirement for crowdfunding portals was one of the reasons Ontario did not adopt the Start-Up Crowdfunding Exemptions.

The proposed exemptions under 45-108 have yet to be adopted by any of the provincial securities regulatory authorities. According to the CSA Notice, the participating regulators who also published 45-108 continue to work closely with the OSC in developing the proposals relating to the 45-108 crowdfunding exemption. Earlier this year the OSC

reported that it is in the process of reviewing the comment letters received relating to 45-108 with the goal of publishing either in final form or, if warranted, for a second comment period, a crowdfunding prospectus exemption along with regulatory requirements applicable to an online crowdfunding portal by the end of summer 2015.

Salient Features of the Start-Up Crowdfunding Exemptions

The Start-Up Crowdfunding Exemptions are intended to provide an alternative source of capital to non-reporting issuers at an earlier stage of development. Prior to the adoption of the Start-Up Crowdfunding Exemptions, a non-reporting issuer located in a participating jurisdiction that did not wish to issue a prospectus would have been prohibited from crowdfunding investment capital unless it relied on one of the limited number of already existing prospectus exemptions (e.g., accredited investor, family and friends).

The Start-Up Crowdfunding Exemptions further facilitate equity crowdfunding by allowing funding portals to operate as dealers for securities offered through their website without having to register as exempt market dealers under provincial securities legislation, subject to certain conditions.

Non-reporting issuers will be able to conduct a start-up crowdfunding distribution under the Start-Up Crowdfunding Exemptions simultaneously in all of the participating jurisdictions as well as any other jurisdictions of Canada that may adopt the Start-Up Crowdfunding Exemptions in the future.

The prospectus exemption is subject to a number of conditions, including:

- It is available to non-reporting issuers only.
- The issuer distributes eligible securities using an offering document in the prescribed form, which includes basic information about the issuer, its management and the distribution, including how the issuer intends to use the funds raised and the minimum offering amount.
- The issuer group may not raise more than \$250,000 per distribution and is restricted to no more than two distributions under the Start-Up Crowdfunding Exemptions in a calendar year.
- No person may invest more than \$1,500 per distribution (note, there is no limit on the number of distributions in which an investor may participate).
- The distribution may remain open to up to a maximum of 90 days.
- The distribution must be made through a funding portal that either relies on the start-up registration exemption or is operated by a registered dealer.
- The issuer must provide each purchaser with a contractual right to withdraw its offer to purchase securities within 48 hours of the purchaser's subscription or notification to the purchaser that the offering document has been amended.

- The securities issued are subject to an indefinite hold period and can only be resold under another prospectus exemption or under a prospectus.
- None of the promoters, directors, officers and control persons (collectively, the principals) of the issuer group may be a principal of the funding portal.

The registration exemption is also subject to its own set of conditions, including:

- The funding portal must deliver a funding portal information form and individual information forms for each of its principals to the participating regulators at least 30 days prior to facilitating its first start-up crowdfunding distribution.
- The head office of the funding portal must be located in Canada.
- The majority of the funding portal's directors must be Canadian residents.
- The funding portal may not provide advice to a purchaser or otherwise recommend or represent that an eligible security is suitable, nor may it speak to the merits of the investment.
- The funding portal may not receive a commission, fee or any other amount from a purchaser of eligible securities (note, a funding portal is only entitled to receive a commission and/or fee in respect of a distribution from the issuer).
- the funding portal must make the issuer's offering document and the associated risk warnings available online to purchasers and may not allow a subscription until the purchasers have confirmed that they have read and understood these documents.
- The funding portal must hold the purchasers' assets separate and apart from its own property, in trust for the purchasers and, in the case of cash, at a Canadian financial institution.
- The funding portal must either (a) release funds to the issuer after the minimum offering amount has been reached and provided that the 48-hour right of withdrawal has elapsed or (b) return the funds to purchasers if the minimum offering amount is not reached or if the start-up crowdfunding distribution is withdrawn by the issuer.
- A participating regulator may not have notified the funding portal that it cannot rely on the start-up registration exemption because its principals or their past conduct demonstrate a lack of integrity, financial responsibility or relevant knowledge or expertise.

CRA Confirms Tax Implications in Respect of Crowdfunding Activities

The CRA recently reiterated in CRA document no. 2015-057903117 – Crowdfunding (April 1, 2015) its view that, generally, whether funds received by a taxpayer in the context of crowdfunding activities will be construed for Canadian tax purposes as either a loan,

capital contribution, gift, income or a combination thereof, will depend on the terms and conditions of the particular crowdfunding arrangement. However, the CRA clearly stated its position that, for federal income tax purposes, amounts received as a result of a crowdfunding arrangement by a taxpayer that carries on a business or profession will be taxable income unless it can be shown that the crowdfunding arrangement otherwise clearly represents a loan, capital contribution or other form of equity.

Based on the foregoing, it is clear that amounts received by a taxpayer from reward-based crowdfunding activities should be included in computing the recipient taxpayer's income from carrying on a business in the taxation year of receipt. In contrast, amounts received by a taxpayer from equity-based crowdfunding activities are not required to be included in computing the recipient taxpayer's income from carrying on a business in the taxation year of receipt. The CRA has also indicated that reasonable costs incurred by a taxpayer that are related to such a crowdfunding arrangement would likely be deductible in computing the recipient taxpayer's income.

With respect to the foregoing, the technical interpretation also references recent amendments to Folio S3-F9-C1: *Lottery Winnings, Miscellaneous Receipts and Income (and Losses from Crime)* (the Folio). More specifically, paragraph 1.5 of the Folio now states that amounts received from contributors by a business using crowdfunding as a method of raising funds will be included in income pursuant to subsection 9(1) of the Act where contributors do not receive any form of equity.

The views expressed in this recent position are not inconsistent with the CRA's prior published positions, for example, CRA document no. 2013-0484941E5 – Crowdfunding (August 16, 2013) and CRA document no. 2013-0507541E5 – Crowdfunding (January 3, 2014). Revenu Québec's published position is consistent with that of the CRA (Demande d'interprétation: 13-019260-001 – Traitement fiscal du financement participatif [28 février 2014]).

In a 2013 ruling published by the CRA (referred to in the preceding paragraph), the Income Tax Rulings Directorate rendered a ruling on the income tax implications relating to a given taxpayer's crowdfunding activities; however, the taxpayer's queries on the sales tax implications relating to said crowdfunding activities were deferred to the GST/HST Rulings Directorate. The GST/HST Rulings Directorate has yet to provide any comments. As a result, there may be some uncertainty as to the manner in which GST/HST (and GST/QST in Québec) would apply in this context. A taxpayer (except for a "small supplier" as that term is defined in the *Excise Tax Act* and for purposes of the *Act respecting the Québec sales tax*) engaged in reward-based crowdfunding activities may be required to collect Canadian federal (and the corresponding provincial sales tax) in respect of the supply of goods and services to the extent that these goods and services constitute a "taxable supply" (as that term is defined in the *Excise Tax Act* and for purposes of the *Act respecting the Québec sales tax*) made in Canada. It should be noted that the obligation

to collect sales taxes is dependent on a number of factors. Indeed, the *Excise Tax Act* is not without its own challenges and pitfalls. However, if applicable, this obligation could mean that there may be an initial cost to reward-based crowdfunding activities equal to the federal and provincial sales taxes to be collected and remitted, if any, by a taxpayer engaged in reward-based crowdfunding activities. In contrast, more traditional forms of equity and debt financing are not subject to sales tax. That being the case, equity-based crowdfunding would not likely be subject to sales tax.

Conclusion

The long-awaited Start-Up Crowdfunding Exemptions reflect the CSA's view that equity crowdfunding can become a viable source of capital to non-reporting issuers at an early stage of development and represents a further step towards the finalization of the equity crowdfunding proposals contemplated under *Regulation 45-108 respecting Crowdfunding*.

Companies interested in offering securities through a funding portal should be aware that depending on the jurisdiction in which the company or investors are based, different regulatory regimes may apply. Depending on the chosen crowdfunding variant and the terms and conditions thereof, the amounts received may be included in computing the recipient taxpayer's income and sales taxes may have to be collected. As discussed, there are Canadian income and sales tax implications which may arise in respect of the model of crowdfunding adopted by a start-up or early stage corporation. This is particularly so in the context of reward-based crowdfunding activities.

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