Kongens Lyngby, April 10, 2014

Crowdfunding and Tax Consequences

1. Introduction

Crowdfunding is emerging around the world and attracts more and more interest from both investor and investees. Crowdfunding is also evolving in Denmark despite certain legislative barriers. Danish crowdfunding associations and platforms are in place to facilitate and promote crowdfunding.

We have been asked by the Danish Crowdfunding Association and Boomerang.dk to analyze the different tax consequences for Danish and Foreign investors and a Danish investee in the different crowdfunding models.

Please be aware that the below general presentation does not include VAT consequences and cannot replace actual and concrete legal advice. Moreover, CORIT Advisory does not assume professional liability with respect to the content presented.

2. Crowdfunding Models

Crowdfunding is a collective term for a variety of alternative financing models where a project or company is financed by a large pool of investors (crowd). Crowdfunding is inter alia used in non-profit projects, political campaigns, commercial projects and start-up companies. There are four main models of crowdfunding:

1. Donation based model
2. Reward based model
3. Debt based model
4. Equity based model

The models differ in levels of commitment of both the investor and investee.

2.1. Donation Based Model

The donation based model of crowdfunding involves an element of charity or generosity. The investor simply donates money to the project or company without any financial return or other tangible benefits. In other words, the investee is granted a donation with no strings attached. However, the donation might offer the investors the opportunity to get connected with the investee or use the donation for advertising purposes.

The donation based model is mainly used with respect to culture, art, science etc.

2.1.1. Taxation of the investor

The investor donates money without any return. As a main rule, such a cost is not deductible for a Danish investor. However, exceptions do apply.

Firstly, the donation is deductible if the donation is related to the investor's business and is incurred for advertising or similar with the aim of selling goods or services. Therefore, the investor must substantiate that the donation is used for advertising purposes, that the level of the donation is reasonable and that the advertisement sufficiently targets the investor's target group.

Secondly, the donation is deductible if the investee is recognized as a charity in Denmark or in an EU/EEA country. If so, a Danish investor can deduct donations up to a total of 14,800 DKK per year (2014). The majority of crowdfunding projects do not fulfill this criterion.

Whether a foreign investor can deduct the donation depends on the tax laws in the residence state.

2.1.2. Taxation of the investee

The investee receiving a donation is taxable with a few exceptions.

Donations to individuals (non-incorporated investees) from a spouse, in-laws, parents, grandparents, children or grandchildren are tax exempt. Instead a gift duty is levied on the donation in certain situations:

- Donations from grandparents, step-grandparents, parents, stepparents and children are not levied with a gift duty up to 59,800 DKK (2014). Donations exceeding this amount is levied a gift duty of 15 % of the excess amount.
- Donations from stepchildren and grandchildren are not levied with a gift duty up to 59,800 DKK (2014). Donations exceeding this amount is levied a gift duty of 36.25 % of the excess amount.
- Donations from in-laws are not levied with a gift duty up to 20,900 DKK (2014). Donations exceeding this amount is levied a gift duty of 15 % of the excess amount.

Donations to certain charity organizations, associations and independent foundations are tax exempt. This does not include limited companies or individuals. The majority of crowdfunding projects do not fulfill this criterion.

2.2. Reward Based Model

In the reward based model the investor is rewarded with a tangible benefit (asset) - typically the first example of the product developed by the investee. Differentiated rewards are often used to attract larger investments. The reward model has many similarities with a purchase of goods or services.

The reward based model is very popular and particularly used in creative industries, such as the movie, music and software industry.

2.2.1. Taxation of the investor

The investor invests in the project or company in return for receiving a reward. Generally speaking, the investment is a non-deductible acquisition cost for the investor. Further, the received reward is not taxable and the resale of the reward is not taxable. However, two exceptions apply.

Firstly, if the investor uses the reward (asset) in the business, the investor might be able to write-off depreciations on the asset. Further, a resale of the asset will result in taxation of the recaptured depreciations.

Secondly, if the investor invests with the purpose of making profit on the resale of the reward (asset), the resale of the asset will be taxed and the investment (acquisition cost) can be deducted from the sales price.

It should be noted that if the investment far exceeds the value of the reward, the investment may be wholly or partly considered a donation. If so, the donation part of the investment is treated as described in section 2.1.1.

Lastly, if the reward constitutes an option for the investor to buy an asset at a fixed price at a specific time in the future, capital gains may be taxed in the period between the investment and the exercise date. However, it depends on the specific circumstances and must be analyzed in each specific case.

Whether a foreign investor can deduct the investment or will be taxed on the reward depends on the tax laws in the residence state. There are no tax consequences in Denmark.

2.2.2. Taxation of the investee

The investee receives payment for the sale of the reward (good or service). Therefore, the investee is taxed on the profit or can deduct a loss depending on whether the sales price exceeds the cost of the good or service.

It should be noted that if the investment far exceeds the value of the reward, the investment may be wholly or partly considered a donation. If so, the donation part of the investment is treated as described in section 2.1.2.

Lastly, if the reward constitutes an option for the investor to buy an asset at a fixed price at a specific time in the future, capital gains may be taxed in the period between the investment and the exercise date. However it depends on the specific circumstances and must be analyzed in each specific case.

2.3. Debt Based Model

The debt based model is a lending arrangement between the investors (crowd) and the investee. The debt based model is also known as peer-to-peer lending. The loan is to be repaid and the investor often receives a financial return (interests etc.). Usually, the investor receives higher interests than available on bank deposits, while the investee pays lower interest rates than on conventional funding - if even available.

In Denmark the investee has to comply with prospectus rules etc. Further, the intermediary (facilitator) of the investment may be considered an investment company. If so, the facilitator must comply with the same requirements as banks, such as solvency requirements and be supervised by the Danish Financial Supervisory Authority. However, it seems that there is political willingness to amend the legislative constraints.

2.3.1. Taxation of the investor

The investor lends money to the investee. The mere disbursement of the loan is not deductible nor is the repayment of the loan taxable. However, the return on the loan will be taxable – both interest and capital gains on the loan (repayment of more than the disbursement). Individuals with yearly net capital gains less than 2,000 DKK are not taxed according to a de minimis rule.

If the investee is not able to repay the loan, the investor can deduct the loss. However, in situations where an investor is controlling the investee, or the investor and investee are group companies, the investor cannot deduct the loss. Individuals obtaining a yearly net capital loss less than 2,000 DKK are not deductible (de minimis rule).

Whether a foreign investor is taxed on the return on the loan depends on the tax laws in the residence state. A foreign investor is only taxed in Denmark if the investor and investee are group companies, which seldom is the case in crowdfunding.

2.3.2. Taxation of the investee

The investee is not taxable of the disbursement of the loan and cannot deduct the repayment of the loan. However, the return (interest and capital losses) on the loan can be deducted in some cases.

As a main rule, interest expenses and capital losses on the loan are deductible. However, individuals cannot deduct losses on the loan. Individuals can only deduct such capital losses if the loan is not issued in Danish kroner (DKK) and the losses exceed 2,000 DKK in the income year.

If the investee is not able to repay the loan, the investee will have a capital gain. As a main rule, companies are taxable of such a capital gain. However, capital gains are tax exempt if the loan is written down to the market value in a collective arrangement with creditors or a compulsory settlement or the investor and investee are group companies. For individuals, capital gains are tax exempt, but certain exemptions apply if the loan is written down below market value, the loan was to be repaid at an amount lower than the initial loan amount or the loan is not issued in Danish kroner (DKK).

2.4. Equity Model

In the equity based model the investor invests money in the investee in return for shares (ownership) in the investee. The equity based model will often result in many shareholders (crowd) with small shareholdings. The equity model is often more complex than the other crowdfunding models and the investors are often motivated by commercial reasons.

In Denmark the investee has to comply with prospectus rules etc. Further the intermediary (facilitator) of the investment may be considered an investment company. If so, the facilitator must comply with the same requirements as banks, such as solvency requirements and be supervised by the Danish Financial Supervisory Authority. However, it seems that there is political willingness to amend the legislative constraints.

2.4.1. Taxation of the investor

The investor invests money in the investee in return for shares in the investee. The disbursement of the investment is not deductible for the investor and the received shares are tax exempt. Generally speaking, the resale of shares and received dividends are taxable.

For individuals, capital gains on shares and dividends are taxable at a rate of 27% up to 49,200 DKK (2014) and 42 % hereafter. Capital losses on shares are deductible – however, for a deduction of capital losses on listed shares it is conditional that the purchase was initially reported to SKAT.

For companies, capital gains on shares in which the investor owns at least 10% of the share capital (listed or unlisted) or owns less than 10% of the share capital in an unlisted company, a capital gain is tax exempt. On the other hand, capital losses are not deductible under such circumstances. Dividends are tax exempt if the investor owns at least 10 % of the share capital. In all other circumstances dividends are taxable. The typical crowdfunding investor would own less than 10 % of the share capital and therefore be tax exempt on capital gains, but taxable on dividends.

A foreign investor is not taxed in Denmark on capital gains on shares, but will be taxed on received dividends (withholding tax). Dividends are taxed with 27 %, which can be reduced to 15 % or even lower, depending on the agreement between Denmark and the resident state of the investor. However, for company investors dividends are tax exempt if the investor owns at least 10 % of the share capital and the taxation were to be reduced according to an agreement between Denmark and the resident state of the investor or the Parent-/Subsidiary Directive.

2.4.2. Taxation of the investee

The investee receives an investment in exchange for issuing shares. The invested capital is tax exempt for the investee and the issuing of shares are not deductible.

If the investee distributes dividends, such distributions are not deductible.

3. Summary

There are four main crowdfunding models, which all have different tax consequences for the investor and the investee. The Danish tax consequences are summarized in the following table:

	Investor	**Investee**
Donation model	Main rule: No deduction. Exc. 1: Donations related to the business of the investor. Exc. 2: Donations to an approved charity. Up to 14,800 DKK per year (2014) are deductible.	Main rule: Taxable. Exc.: Donations received from family are tax exempt, but may be levied with a gift duty.
Reward model	Main rule: No deduction for the investment and no tax on the reward received. No tax on resale of the reward. Exc. 1: Investor using the reward (asset) in the business might be able to write-off depreciations on the asset. If so a resale of	Tax/deduction on the net gain/loss.

	the asset will result in taxation of recaptured depreciations. Exc. 2: Investors investing with the purpose of making profit on the resale of the reward. Capital gains on the resale are taxable and capital losses can be deducted.	
Debt model	No deduction for the disbursement and no taxation of the repayment. Interest and capital gains are taxable, while capital losses are deductible. Exceptions do apply as described in section 2.3.1.	No taxation on the disbursement and no deduction for the repayment. Companies: Interest and capital losses are deductible, while capital gains are taxable. Individuals: Interest is deductible. Capital losses are not deductible, while capital gains are tax exempt. Exceptions do apply as described in section 2.3.2
Equity model	No deduction for the disbursement and no taxation of the received shares. However received dividends and capital gains on the subsequent sale of shares are taxable, while capital losses are deductible. Exceptions do apply for companies as described in section 2.4.1.	The investment received is tax exempt and the issuing of shares is not deductible. Distribution of dividends is not deductible.