

# INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

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Volume 7 | Issue 2

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2024

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# Crowdfunding in the Digital Age and its Legal Implications

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## ABSTRACT

*The modern economy has embraced crowdfunding, which is a type of financing that can be funded through digital channels. This article goes into the depth of dynamics of crowdfunding in the digital age and study its legal implications.*

*Crowdfunding has altered the access to capital, allowing entrepreneurs, creators, and social causes to move beyond traditional crowdfunding platforms. This research investigates the shifting regulations surrounding crowdfunding and evaluates how to foster innovation and entrepreneurship. This is necessary to protect the interests of investors and maintain the integrity of the market. It examines the regulatory responses of different jurisdictions and highlights the different approaches that have been taken to balance investment protection with capital formation.*

*The Article draws attention to challenges of applying traditional legal principles in a decentralized and unbounded nature crowdfunding platforms. The challenges of ensuring regulatory compliance and investor protection are significantly amplified by jurisdictional ambiguity, enforcement mechanisms, and cross-border transactions, it also makes an international comparison of regulatory guidance, and empirical research to explain evolving aspects of crowdfunding law and policy.*

*Finally, this article recommends a diverse and forward-looking approach to crowdfunding regulation that balances the financial playing field inclusion, market efficiency and investor protection in the rapidly developing digital economy. Interdisciplinary collaboration and stakeholder involvement in crowdfunding can help policymakers, lawyers, and industry stakeholders navigate the legal challenges of the medium-sized fund, thereby creating a dynamic and sustainable ecosystem for innovation and economic empowerment.*

*Keywords: Crowdfunding, Regulatory, Investor.*

## I. INTRODUCTION

A project or business can be funded through crowdfunding, which involves gathering funds from a large number of individuals, usually via the Internet. Even though mail order, benefit events, and other methods can implement similar ideas, crowdfunding refers to registries

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mediated through the Internet.<sup>2</sup>

A range of for-profit business ventures, including arts and creative projects, have been backed by crowdfunding furthermore projects can also be medical projects, expenses, travel and community based social enterprises. The correlation between crowdfunding and sustainability has been suggested, but the investigation has revealed that sustainable development encompasses more than just crowdfunding. Criticism has been directed towards its utilization for financing health care fraud, specifically expensive and phony cancer remedies.

The process of raising funds for projects or businesses has been transformed by the introduction of crowdfunding. Crowdfunding has become a prevalent means of connecting content creators with potential supporters online, thanks to the Internet. Each type of crowdfunding has its own set of advantages and drawbacks.

**Donation based Crowdfunding:** Donors can contribute money to a project without receiving any financial compensation in the form of crowdfunding.

**Rewards Based Crowdfunding:** Incentives or rewards can be offered by project creators in the context of rewards-based crowdfunding. These benefits can range from early access to products, exclusive merchandise, or personal experiences.

**Equity-Based Crowdfunding:** Shares or stock in a company are offered to supporters of the deal through equity crowdfunding. Crowdfunding is commonly used by startups or companies seeking funding and having a larger investor pool.

## **II. REGULATOR**

The crowdfunding industry in India is regulated by the Securities and Exchange Board of India (SEBI). Investor protection is the main objective of the regulator. Donation and reward Crowdfunding only asks for donations or grants, and no financial return or income is expected from the invested capital. Therefore, the management of such financing is largely the responsibility of the stock market regulator. Regardless of whether the loans are pure or issued debt securities, peer-to-peer loans are subject to regulation by banking or securities regulators. SEBI has the primary responsibility for monitoring equity crowdfunding.<sup>3</sup>

Companies wishing to issue securities to the public must comply with the Companies Act, 2013 and related regulations relating to public offers (excluding the requirements of SEBI

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<sup>2</sup> Goran Calic, "Crowdfunding", *The SAGE Encyclopedia of the Internet*, 2018.

<sup>3</sup> Chet Jainn, "Crowdfunding industry eyes clarity on regulation and legal accountability in Budget 2022", Access here: <https://economictimes.indiatimes.com/small-biz/sme-sector/crowdfunding-industry-eyes-clarity-on-regulation-and-legal-accountability-in-budget-2022/articleshow/89194162.cms?from=mdr>.

regulations). The regime for debt securities is easier to comprehend as the issuer must comply with the SEBI Issue and Listing of Debt Securities (ILDS) Regulations, 2008, which require basic requirements such as bond manager and credit, classifications, disclosure requirements, etc.

Publishers use donation-based crowdfunding to collect donations directly from donors, while prizes such as movie tickets, computer games, and book downloads can be funded through prize-funding methods. Peer-to-Peer lending, which is exempt from SEBI regulation are not regulated by the regulator. It generally does not involve the emission of securities for financial gain and may require the approval of other regulatory authorities. Peer-to-peer lending is subject to the RBI's authority.

### **III. INVESTOR PROTECTION**

Funding is a new way of providing modest investments to young entrepreneurs and technology professionals who need seed or seed capital that can accelerate a business spirit and help transform the real economy.

Through social media, companies can offer investors their company's stock or debt for a small amount of money on online crowdfunding platforms and websites, this is also a type of business.

When the expense of observing investor protection laws prohibits it, crowdfunding may not be an effective means of raising capital. Despite potential security issues, investors don't necessarily want to invest in crowdfunding without proper safeguards. Accordingly, the proposal aims to strike a balance between safeguarding retail investors while also opening up capital markets and providing investor protection without imposing excessive entry barriers or regulatory burdens on the issuer.

The sector requires a suitable implementation framework and regulatory procedures to maximize its potential. The ambiguity of the matter limits its scope. Millions of people have been aided during Covid by the use of crowdfunding.

### **IV. REGULATIONS IN OTHER COUNTRIES**

The US, UK and other countries have established rules for obtaining capital from small businesses, minimal bureaucratic hurdles in raising funds, and strong investment protection for small investors, even the middle class. India's law mandates that insurance companies and mutual fund companies disclose the liabilities and risks associated with fundraising, resulting in greater accountability among fundraisers to ensure their appeal is clearly presented. The crowdfunding industry in India is anticipating straightforwardness and transparency based on

the government's guidelines.<sup>4</sup>

In several nations with a lower population density than India, specific crowdfunding regulations have been implemented, enabling businesses/individuals and charities to exploit the popularity of crowdfunding for their events. For those who are unable to obtain traditional funding, crowdfunding is entering a new phase.

Equity crowdfunding presents a novel approach to funding concepts and ground-breaking inventions. Some nations are seeing quick advancements in the introduction of equity crowdfunding platforms, while others are implementing them more slowly.

Equity crowdfunding platforms are permitted in many jurisdictions, such as the US, UK, and Japan, as an exemption to the standard requirements of a public offering involving the use of a prospectus or offering memorandum.

## **V. INTELLECTUAL PROPERTY WITH CROWDFUNDING**

The process of creating regulations for charity crowdfunding is challenging. In our country, it's crucial to establish standards of transparency and privacy that apply to organizations & fundraising agencies when they look for new donors.

A number of platforms have been created across all industries to address the various structural issues surrounding intellectual property and provide a practical mechanism for authors to protect their works, often offering flawed guidance and recommendations. For example, Kickstarter, one of the most important payment crowdfunding systems, has specific rules for certain types of intellectual property that make a lot of sense. The platform requires content creators to demonstrate their complete ownership of the rights to their company in all aspects and with appropriate authorization from the owner. Crowdfunding platforms' function in safeguarding intellectual property Crowdsourcing is a collaborative method of obtaining ideas, services, or content material by regularly soliciting contributions from a large group of people over the web in a reasonably dominant manner. In practice, it also demonstrates how well identifying the true owners of intellectual property can be a complicated project that requires caution and clean contract preparations that demonstrate competence in crowdsourcing.

The utilization of crowdfunding sites by fraudulent entities for fundraising must be prohibited. The requirements for the crowdfunding platform's owner and key players to meet must be characterized by honesty, experience, and solvency. Only a crowdfunding platform approved

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<sup>4</sup> Consultation Paper on Crowdfunding in India, SEBI, Access here: [https://www.sebi.gov.in/sebi\\_data/attachdocs/1403005615257.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/1403005615257.pdf) .

by SEBI is recommended for conducting online offers or transactions.

Crowdfunding platforms may impose a little charge on companies seeking to raise capital through the platform and accredited investors looking for profitable ventures; however, the companies' listings are subjected to a strict screening and due diligence procedure.

## **VI. CROSS BORDER CROWDFUNDING**

An illustration of cross-border crowdfunding in accordance with international law and regulation can be provided by comparing two hypothetical scenarios in which countries handle crowdfunding fundamentally opposites. Essentially, reflect on the situation involving New Zealand supposedly one crowdfunding-friendly jurisdiction—and India, where equity crowdfunding is prohibited.

The laws governing crowdfunding in New Zealand are incredibly liberal and progressive; there are no limitations on individual investments and no distinctions made between private and established investors. Despite this, New Zealand crowdfunding platforms ensure that publishing companies are thoroughly checked before bidding. They believe that crowdfunding sites must establish a reputation for supporting quality companies to attract and retain aspiring investment publics.

## **VII. ETHICAL PROBLEMS WITH CROWDFUNDING**

How do regulators handle such situations when there are no regulations on equity crowdfunding? For instance, if a company offers securities overseas, it must be audited according to the relevant domestic legislation. What is more concerning is the participation of experienced investors in equity crowdfunding projects abroad. This problem can be split into two parts. Initial point being place of origin refers to whether the purchase and ownership in foreign securities are permitted or prohibited, respectively. The other point being coercion.

Crowdfunding can be used to find an ethical solution to an issue, but it can also create new moral dilemmas. Crowdfunding already has a solution at its heart for traditional hurdles to financing access, which fits in nicely with the practical mindset of reform and advancement in society. By managing and fostering economic fluctuations in recent years, traditional financial institutions have come under growing distrust and disappointment.<sup>5</sup> One way to combat this is through crowdfunding. As a result, anyone with internet access can get funds for their chosen project from anybody else sharing the same connection. This calls for further democratization

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<sup>5</sup> Mike Kappel, What is Crowdfunding and How can it take your business to the next level, Access here: <https://www.patriotsoftware.com/blog/accounting/what-is-crowdfunding/>

in the allocation and use of financial resources as well as increased discourse in the public sphere regarding future purchasing decisions, the purchase of public goods, and uncontrolled propagation of ideas.<sup>6</sup>

First off, crowdfunding is based on the liberalization of finance principles, which means that: (1) a competitive crowd offer weakens the absolute control of traditional financial organizations and their requirements for distributing funds to individuals, organizations, or projects; (2) supports funding for individuals, organizations, and projects as a whole, especially from societies where bias against women, men, and ethnic minorities is widespread; (3) gives more people and organizations the ability to influence efforts to develop goods and services to meet their future requirements as consumers while slightly reducing the authority of businesses such as manufacturers, wholesalers, and retailers to make such choices on their behalf; (4) may present additional possibilities for investments as a whole for individuals and organizations, and (5) The reduction of social inequality can be achieved through better financing and investment opportunities over a longer period.

Secondly, Crowdfunding can be of great assistance in delivering public goods that are not accessible to established institutions. Such special projects can be e.g. Funding for healthcare, education, research, and equipment requirements, municipal procurement of renewable energy solutions for electricity consumption, community cultural activities, facilities, restoration, maintenance.

## VIII. CONCLUSION

Content producers and contributors need to be aware of the risks. Contributors sometimes don't work, and supporters do, but they rarely receive the benefits that they want. All of us should be offered equal chances regardless of our financial situations. Content creators carry the responsibility of exploiting other people's work. Information security, both financial and personal, ought to be the priority. One should be on the lookout for fraudulent projects and false conduct right away. The project ought to go further than simply trying to raise money and include a long-term planning process. Content producers need to consider the environmental and social implications of what they produce.

While crowdfunding can lead to creative and inspiring businesses, the sector as a whole has to keep up its high standards of legitimacy. Ethical crowdfunding should preserve intellectual property and privacy rights, guarantee long-term sustainability, and foster genuine and

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<sup>6</sup> Darshan Supekar, *The Future of Crowdfunding in India: Trends and Predictions*, Access here: [https://www.ketto.org/blog/future-of-crowdfunding-in-india\\_](https://www.ketto.org/blog/future-of-crowdfunding-in-india_)

forthright communication.

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