
ANALYSING LEGAL POSITION OF EQUITY-BASED CROWDFUNDING IN INDIA AND COMPARATIVE ANALYSIS WITH THE USA

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ABSTRACT

This paper analyses the legal position of equity-based crowdfunding in India through a comparative study of the regulatory framework in the United States. Equity crowdfunding enables startups and small enterprises to raise capital from a large number of investors through online platforms in exchange for equity securities, thereby emerging as a significant alternative to conventional financing mechanisms. While the United States has developed a comprehensive regulatory framework through the Jumpstart Our Business Startups (JOBS) Act and Regulation Crowdfunding, India continues to lack a dedicated legal regime governing equity crowdfunding.

The paper examines the existing Indian legal framework under the Companies Act, 2013, the SEBI Act, and related securities regulations, highlighting the challenges of applying traditional private placement provisions to digital crowdfunding models. It further analyses key judicial and regulatory developments, including the Sahara case and recent actions initiated by the Registrar of Companies against crowdfunding-linked issuances, to demonstrate the regulatory uncertainty surrounding such activities in India. The study also evaluates SEBI's 2014 Consultation Paper, which proposed a regulated crowdfunding framework limited to accredited investors and recognised intermediaries, but has not yet been implemented.

In contrast, the paper explores the comparatively structured framework adopted in the United States, focusing on investor eligibility, issuer obligations, intermediary regulation, disclosure requirements, and restrictions on transferability of securities. Through this comparative analysis, the paper argues that India's restrictive and uncertain regulatory approach may hinder innovation and limit access to capital for startups and SMEs. It concludes by emphasising the need for a balanced regulatory framework that simultaneously promotes entrepreneurial growth, technological innovation, investor protection, and market transparency within India's evolving financial ecosystem.

1. Introduction

In contemporary times, an array of startups offering diverse products and services receive substantial encouragement. However, many of these ventures, alongside other small companies, encounter obstacles in accessing funding through conventional methods like IPOs due to their limited scale.¹ As a result, crowdfunding emerges as an appealing option, offering these entities a viable avenue to raise funds and propel their growth all over the world.²

Crowdfunding is a financial approach where small amounts of money are gathered from a large number of individuals or organisations to fund various ventures, projects, or personal needs. First coined by Michael Sullivan in 2006, the term crowdfunding describes “the efforts by entrepreneurial individuals and groups...to fund their ventures by drawing on comparatively small contributions from a large number of individuals using the Internet, without standard intermediaries”³ It operates through online web-based platforms, encompassing models like peer-to-peer lending and equity crowdfunding. The International Organization of Securities Commissions (IOSCO) categorises crowdfunding into four types: donation crowdfunding, reward crowdfunding, peer-to-peer lending, and equity crowdfunding.⁴

2. Equity-Based Crowdfunding

Equity-based crowdfunding is a dynamic fundraising method that revolutionises traditional financing models by allowing businesses to issue equity interests to a broad spectrum of investors through online crowdfunding platforms.

In its consultation paper, SEBI defines crowdfunding as the solicitation of small funds from multiple investors via web-based platforms or social networking sites for specific projects, business ventures, or social causes.⁵ It is a method of raising funds for creative projects, public-interest causes, or businesses through small financial contributions.⁶ Security-based crowdfunding is a subset of Financial Return Crowdfunding, comprising equity, debt, and

¹ Arjya B. Majumdar & Umakanth Varottil, *Regulating Equity Crowdfunding in India: Walking a Tightrope*, in GLOBAL CAPITAL MARKETS 172 (2017),

² Manoj Kumar Joshi, *Crowdfunding For Startups in India.*, 24 AWESHKAR RESEARCH JOURNAL (2018),

³ Kenny Ozuna, *Equity Crowdfunding in the United States: Evolution, Determinants and Performance.*

⁴ Eleanor Kirby & Shane Worner, *Crowd-Funding: An Infant Industry Growing Fast.* p 4

⁵ Para 2.1 and 2.2, Consultation Paper on Crowdfunding in India, Securities and Exchange Board of India.

⁶ Para 2.1, *Id.*

fund-based crowdfunding.⁷

Equity crowdfunding platforms, such as Crowdcube and Seedrs, provide businesses with an alternative to traditional funding sources, enabling solicitation of investment at earlier stages than conventional equity offerings. This allows entrepreneurs to present their ideas online, inviting investment from a diverse range of investors.⁸ These platforms represent a shift in capital acquisition, challenging conventional approaches like private equity, angel investments, and institutional loans by allowing businesses to offer equity interests to online investors through crowdfunding platforms.

3. Existing Legal Framework in India

Although equity-based crowdfunding is not yet legal in India, SEBI took a step towards its regulation by releasing a consultation paper in 2014. However, this paper has not yet been translated into official regulations. Despite the absence of specific regulations for equity-based crowdfunding, the existing legal framework in India relevant to equity-based crowdfunding transactions encompasses regulations primarily governed by the Companies Act 2013 (CA, 2013) and various statutes under the Securities Act, including the SEBI Act of 1992, SEBI Regulations, and the Depositories Act of 1996. Public issuance of securities by companies falls under the purview of the CA, 2013, in conjunction with SEBI Regulations. Companies issuing public securities are required to submit a listing application to recognised stock exchanges and file a Prospectus with the Registrar of Companies. SEBI (ICDR) Regulations, 2009, outlines stringent requirements for public issuance, including the appointment of merchant bankers, filing of draft offer documents, and compliance with disclosure mandates.

Moreover, SEBI has implemented measures to facilitate funding for startups and SMEs through initiatives like the SME Segment of Exchanges, the Innovators Growth Platform (IGP), and the Category I SME Fund under AIF Regulations. These platforms provide specific criteria for SMEs to list their securities, offering relaxations such as direct filing of draft offer documents and exemptions from specific eligibility criteria. Additionally, the IGP allows SMEs to list specified securities without an IPO, targeting informed investors with mandated trading lots.⁹

⁷ Para 3.1, *Id.*

⁸ The Benefits of Online Crowdfunding for Fund-Seeking Business Ventures - Macht - 2014 - Strategic Change - Wiley Online Library, <https://onlinelibrary.wiley.com/doi/epdf/10.1002/jsc.1955> (last visited Apr 8, 2024).

⁹ Ch X, SEBI | Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements)

Furthermore, SEBI has introduced regulations¹⁰ for Alternative Investment Funds (AIFs) to regulate privately pooled investment vehicles. The regulations categorise AIFs into three types based on their investment objectives, with specific criteria and restrictions tailored to each category. AIFs are prohibited from making public invitations and must adhere to investment value and investor limits, aiming to foster investment in startups and SMEs while managing risks in the alternative funds sector.¹¹

Additionally, the Companies Act imposes regulations on private placements of securities, limiting such placements to 200 persons annually, excluding Qualified Institutional Buyers (QIBs) and employees under a stock option scheme. Strict procedures are mandated for private placements, including directing offers to recorded names, processing payments through banking channels, and ensuring prompt allotment or refund of funds. Notably, a nuanced approach exists for QIB entities, exempting them from the 200-person limit and demonstrating a tailored regulatory stance towards private placement regulations.¹²

Crowdfunding vis-a-vis Private Placement

The Sahara Case¹³ underscores the dynamics of equity-based crowdfunding within the Indian legal framework. Sahara India Real Estate Corporation Ltd. and Sahara Housing Investment Corporation Ltd. aimed to raise funds through optional fully convertible debentures (OFCDs) on a private placement basis, intending to distribute them solely to select individuals within the Sahara Group, excluding the general public. SEBI intervened, contending that distributing OFCDs to millions constituted a public offer under Section 67 of the CA, 2013. The Supreme Court clarified that any offer to 50 or more persons is public, emphasising private placement entails issuing securities to closely associated individuals without public advertisements. The court ruled the OFCD distribution as a public issue, necessitating compliance with Section 73 of the CA, 2013, mandating securities listing on a recognised stock exchange. While Sahara relied on its network, crowdfunding leverages online platforms, posing similar legal challenges under Section 42 of the CA, 2013.

In March 2023, the Registrar of Companies penalised Anbronica Technologies Pvt. Ltd. and

Regulations, 2018 [Last amended on December 21, 2023].

¹⁰ SEBI | SEBI (Alternative Investment Funds) Regulations, 2012 [Last amended on March 6, 2017].

¹¹ Regulating Equity Crowdfunding in India- A Response to SEBI's Consultation Paper* Arjya B. Majumdar.

¹² S. 42, The Companies Act, 2013.

¹³ Sahara India Real Estate Corp. Ltd. v. SEBI, (2012) 10 SCC 603.

Septanove Technologies Private Ltd. for issuing compulsorily convertible debentures CCDs in violation of Section 42 of the CA, 2013. The companies argued that the issuance was not a public offering as it was limited to the Tyke community, but the ROC disagreed, emphasising that any form of public advertisement, including social media pitches, constitutes a violation of Section 42.¹⁴

Similarly, in a September order¹⁵, the ROC clarified that community subscription offer plans (CSOPs) CSOPs qualify as securities under Section 2(81) of the CA, 2013. SustVest's issuance of CSOPs to 565 subscribers was deemed a violation of Section 42, despite the company's argument that CSOPs are not securities. These cases underscore the importance of regulatory compliance in crowdfunding activities and highlight the challenges associated with navigating the legal landscape in the absence of specific regulations governing equity crowdfunding in India. The ROC's strict interpretation of securities laws poses significant hurdles for crowdfunding platforms, necessitating a clearer regulatory framework to support innovation while ensuring investor protection.

4. Regulatory Framework in the USA

In the United States, crowdfunding regulation is overseen by the Securities Exchange Commission (SEC) through Title III of the Jumpstart Our Business Startups Act (JOBS Act) of 2012, operating within the Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC introduced a new Regulation on Crowdfunding effective from May 16, 2016. This legislation aims to facilitate capital raising for startups and small businesses by offering securities through online crowdfunding platforms, providing exemptions from SEC registration if certain rules are met.¹⁶

4.1. Requirements for Investors

4.1.1. Eligible Investors

¹⁴ Adjudication order of Penalties u/s 42(10) of the Companies Act, 2013 in the matter of Anbronica Technologies Private Limited, Available at : <https://www.mca.gov.in/bin/dms/getdocument?mds=I4whIqT0vI2s3pZZHS8PiQ%253D%253D&type=open>.

¹⁵ Adjudication Order of Penalties u/s 42 of the Companies Act, 2013 in the matter of Solargridx Ventures Private Limited, Available at : <https://www.mca.gov.in/bin/dms/getdocument?mds=sBM4VDe93G9p85DW%252BDkfvA%253D%253D&type=open>.

¹⁶ Divya Ashta, *A Critical Comparative Analysis of the Emerging and Maturing Regulatory Frameworks: Crowdfunding in India, USA, UK*, 26 JOURNAL OF INNOVATION ECONOMICS & MANAGEMENT 113 (2018).

Regardless of certification, anyone can invest in crowdfunding offerings in the US. To reduce risks, there are restrictions on how much an investor can invest in a 12-month period, depending on their net worth and yearly income.¹⁷

4.1.2. Maximum Number of Investors

The US Crowdfunding Regulations do not set a limit on the number of investors permitted to participate in crowdfunding offers through platforms.

4.1.3. Investment Limits

Minimum investment amounts are not specified in the US Crowdfunding Regulations. They do, however, specify the following upper investment limitations for individual investors during a 12-month period: a) An investor's investment is limited to the higher of \$2,000 or 5% of the lesser of their net worth or annual income if they have less than \$100,000 in net worth or annual income. b) The investment is capped at 10% of the lower of their net worth or yearly income if both are equal to or greater than \$100,000. c) In addition, the total quantity of securities sold to a buyer throughout all Regulation Crowdfunding transactions in a given calendar year.

4.2. Requirements for Issuer Entity

Certain types of companies are not qualified to use the Regulation Crowdfunding exemption under the US Crowdfunding Regulations. These comprise: a) Non-US companies; b) Exchange Act-required companies; c) Investment companies and those excluded under Regulation Crowdfunding; d) Companies that did not file their offering statement on time or that did not comply with Regulation Crowdfunding's annual reporting requirements in the two years prior to filing the offering statement; and e) Companies that do not have a specific business plan or that plan to merge with an unidentified entity.¹⁸

4.3. Requirements for Crowdfunding Intermediary or Platform

The US Crowdfunding Regulations mandate that crowdfunding issuers execute their offers only through online platforms run by intermediaries registered as funding portals or broker-dealers and who are also required to be members of the Financial Regulatory Authority

¹⁷ Section 4.6(A) of the Securities Act of 1933 (USA).

¹⁸ SEC.gov | Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers [1].

(FINRA).¹⁹ However, funding portals are subject to limitations in their activities. They are restricted from offering investment advice, soliciting purchases, compensating based on sales, or managing investor funds or securities.²⁰ Any platform engaging in such activities must register as a broker-dealer.²¹

4.4. Restriction on Transferability of Securities

Securities purchased through a crowdfunding site are prohibited from being transferred for at least a year following the date of purchase, as per the US Crowdfunding Regulations. The following situations exempt this lock-in restriction: (i) transfers to the securities' issuer; (ii) transfers to certain accredited investor categories; (iii) transfers as part of an offering filed with the SEC; (iv) transfers to the purchaser's family member or in connection with the purchaser's divorce or death, or other similar situations, at the SEC's discretion.²²

4.5. Applicability of State Laws

Federal law supersedes state law in crowdfunding issues that satisfy Title III requirements, as per Section 305(b) of the JOBS Act. As a result, the problem is released from state requirements for offering, documentation, and registration, yet state authorities have the right to enforce the law.

Furthermore, securities offered and sold exclusively to residents of a single state or territory are exempt from registration requirements and other Securities Act regulations under Section 3(a)(11) of the Securities Act of 1933, provided that the issuer is likewise a resident of that state or territory or conducts business there. Rule 147, in conjunction with this exception, allows for "Intrastate Crowdfunding."

Securities that fall under this exemption are subject to state registration or exemption requirements but are not required to be registered under federal law. Some jurisdictions have enacted exemptions for crowdfunded securities offerings to facilitate intrastate crowdfunding.

¹⁹ SEC.gov | Regulation Crowdfunding: A Small Entity Compliance Guide for Crowdfunding Intermediaries [1].

²⁰ S. 304(b) *JUMPSTART OUR BUSINESS STARTUPS ACT*, PUBLIC LAW (2012); Section 3(a)(80) of the Securities Exchange Act of 1934.

²¹ Section 3(a)(80) of the Securities Exchange Act of 1934.

²² S. 302(b) *JUMPSTART OUR BUSINESS STARTUPS ACT*, PUBLIC LAW (2012); S. 4A (e) The Securities Act of 1933 (15 U.S.C. 77a et seq.)

To improve intrastate crowdfunding, the SEC recently modified its safe harbour compliance guidelines. With the introduction of Rule 147A, the amended regime expands the intrastate offering exemption while maintaining the current Rule 147 safe harbour. As long as sales only take place in the relevant state, this permits some issuers to rely on the federal offering registration exemption even in cases when offers are made outside of it.

5. Comparative Analysis

As mentioned, equity crowdfunding portals are not yet established in India. The Securities and Exchange Board of India has explored options to provide startups and SMEs with access to capital markets.²³ In June 2014, SEBI's consultation paper²⁴ proposed a regulatory framework (Draft Indian Framework) to facilitate crowdfunding in India, aiming to balance investor protection with fundraising opportunities.

Below is a comparative table outlining the differences between the existing legal framework for equity crowdfunding in the United States and the proposed draft framework for equity crowdfunding in India.

	Aspect	US Legal Framework	Draft Indian Framework
1.	Regulatory Authority	Securities Exchange Commission (SEC)	Securities and Exchange Board of India (SEBI)
2.	Legislation	Title III of the Jumpstart Our Business Startups Act (JOBS Act)	Proposed regulatory framework by SEBI
3.	Enactment Date	April 5, 2012	Yet to be enacted
4.	Regulatory Compliance	Regulated under the Securities Act of 1933 and the Securities Exchange Act of 1934	Intended to regulate crowdfunding under the Companies Act 2013
5.	Key Features	Provides an exemption from SEC registration for securities offered through crowdfunding platforms	Aims to facilitate access to capital markets for startups and SMEs while ensuring investor

²³ Divya Ashta, *A Critical Comparative Analysis of the Emerging and Maturing Regulatory Frameworks: Crowdfunding in India, USA, UK*, 26 JOURNAL OF INNOVATION ECONOMICS & MANAGEMENT 113 (2018).

²⁴ Consultation Paper on Crowdfunding in India, Securities and Exchange Board of India.

			protection
6.	Eligible Investors	Any person can invest, subject to limits on investment amount based on net worth and annual income.	Limited to accredited investors, including QIBs, HNIs, and ERIs, meeting specific criteria related to income, net worth, or investment limits.
7.	Maximum Number of Investors	No specified limit.	Maximum of 200 individuals allowed to participate in crowdfunding offers, excluding QIBs.
8.	Investment Limits	No minimum investment limits.	Minimum and maximum investment limits for different investor categories, along with individual and cumulative investment restrictions.
9.	Eligible Companies	Certain types of companies are not eligible, including non-US companies and those subject to Exchange Act reporting requirements.	Unlisted public companies meet specific criteria, with limitations on capital raising over a 12-month period and specific business focus areas.
10.	Issuer Requirements	Compliance with federal regulations and filing requirements, including disclosure mandates.	Mandatory disclosure of financials, ownership structure, risks, and compliance with SEBI regulations.
11.	Requirements for Crowdfunding Intermediary/Platform	Platforms must be registered with the SEC as broker-dealers or funding portals, adhering to operational and conduct standards.	Specific entities like recognised stock exchanges, depositories, and technology incubators can establish platforms subject to SEBI regulations and due diligence requirements.
12.	Due Diligence	Platforms conduct due diligence on issuers and investors, verifying background, financials, and business viability.	Platforms conduct background checks on issuers, directors, and shareholders and assess the business viability of startups.

13	Investor Protection	SEC regulations ensure investor protection, transparency, and adherence to prescribed investment limits.	SEBI regulations mandate investor education, risk disclosure, and compliance with investment limits to mitigate risks.
14	Transferability of Securities	Securities acquired through crowdfunding are subject to a lock-in period with limited exemptions for transferability.	Transfer of securities is allowed under specific conditions, with a lock-in period for promoters and limitations on stakeholding by individual investors.
15	Exit Options for Investors	Investors can exit anytime after the lock-in period, subject to certain exemptions and restrictions.	Exit options are limited to defined events such as company sale, IPO, or listing on a recognized stock exchange, with restrictions on stake holding.
16	State Laws Applicability	Federal law pre-empts state law for Title III crowdfunding, exempting issuers from state registration and offering requirements.	No specific provisions for state law pre-emption, subject to compliance with SEBI regulations and state securities laws.
17	Promoter Requirements	No specific requirements for promoters under federal regulations.	Promoters must maintain a minimum 5 % equity stake for three years from issuance and adhere to SEBI regulations regarding fundraising, reporting, and compliance.
18	Regulatory Restrictions and Permissions	US laws allow crowdfunding platforms to engage in these activities if registered as broker-dealers with the SEC. ²⁵	Indian crowdfunding platforms are restricted from certain activities, such as providing investment advice and managing funds or securities. ²⁶

²⁵ Shekhar Darke, *To Be or Not to Be a Funding Portal: Why Crowdfunding Platforms Will Become Broker-Dealers*.

²⁶ Para 9.4.6, *supra* note 5.

Both regulatory frameworks, notwithstanding their differences, place a strong emphasis on protecting investors through disclosure requirements, requiring issuers to give the following information: a) Financial condition descriptions; b) Beneficial owner details; c) Securities valuation explanations; d) Information of the Ownership and the capital structure; and e) Principal threats to the issuer's business.²⁷

6. Conclusion

Equity-based crowdfunding emerges as a promising avenue for entrepreneurs and investors alike, offering distinct benefits and risks that demand careful consideration. Its transformative potential lies in democratising access to capital, empowering startups and SMEs to connect with a broader investor base and drive innovation. Leveraging online platforms, entrepreneurs can bypass traditional barriers and secure funding, promoting cost-effectiveness and portfolio diversification.²⁸

However, the inherent risks of equity crowdfunding, including default and fraud²⁹, underscore the need for robust regulations to protect investors and maintain market integrity. SEBI's delay in formulating crowdfunding rules leaves the ecosystem vulnerable, hindering its development and eroding investor confidence. Timely intervention is crucial amidst economic uncertainties, fostering innovation and sustaining entrepreneurial endeavours.³⁰

India can learn from the US experience, where equity crowdfunding was incorporated into the legal framework in 2012 through the JOBS Act. This legislation revolutionised capital markets, enabling startups to access funds from a broad investor pool. India must prioritise regulatory clarity to balance investor protection with innovation, positioning itself as a conducive destination for crowdfunding. Collaboration with stakeholders and regulatory counterparts will be vital in fostering transparency, accountability, and trust, catalysing economic growth in the digital age.

²⁷ Para 9.3.3, supra note 5.

²⁸ CA Mohit Bahal, *Role of Crowdfunding in Financing Start-Ups and SME in India*, 2 (2017).

²⁹ Singh, V., 2020. *Crowdfunding in India*. *UGC Care Journal*, 40(60), pp.1743-55.

³⁰ Stuti Shah, *Equity Crowdfunding in India: Towards a Regulatory Framework Corporate Laws*, 4 RGNUL FIN. & MERCANTILE L. REV. [i] (2017).