



CROWDFUNDING FOR NONPROFITS

Legal Considerations for 501(c)(3) Tax-Exempt Organizations

AUTHORED BY
MICHIGAN COMMUNITY RESOURCES
CROWDFUNDING LEGAL TEAM

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DISCLAIMER

THIS GUIDE PROVIDES BASIC INFORMATION FOR NONPROFITS ABOUT FEDERAL AND MICHIGAN LAWS AND TOPICS RELATED TO CROWDFUNDING. THIS GUIDE IS A BRIEF PRIMER ON THE TOPIC AND SHOULD BE USED FOR INFORMATIONAL PURPOSES ONLY.

CONSULT A KNOWLEDGEABLE ATTORNEY BEFORE YOU START RAISING CAPITAL.

RAISING CAPITAL, IN MOST CIRCUMSTANCES, REQUIRES COMPLYING WITH STATE AND FEDERAL SECURITIES LAWS. SECURITIES LAWS CAN BE COMPLICATED AND FAILURE TO COMPLY WITH SECURITIES LAWS CAN EXPOSE BOTH YOU AND YOUR ORGANIZATION TO SIGNIFICANT LIABILITY. AN EXPERIENCED ATTORNEY CAN HELP YOU AVOID THE COMMON PITFALLS THAT CREATE RISK AND LIABILITY WHEN RAISING CAPITAL.

THIS GUIDE IS NOT LEGAL OR FINANCIAL ADVICE. WE ENCOURAGE YOU TO DO YOUR OWN RESEARCH AND MEET WITH THE FINANCIAL AND LEGAL PROFESSIONAL OF YOUR CHOOSING PRIOR TO ENGAGING IN CROWDFUNDING.

IF YOUR NONPROFIT ORGANIZATION HAS A SPECIFIC QUESTION OR LEGAL NEED, PLEASE CONTACT MICHIGAN COMMUNITY RESOURCES OR CONSULT WITH YOUR ATTORNEY.

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Legal Considerations for
501(c)(3) Tax-Exempt Organizations

Acknowledgements

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About The Michigan State Bar Foundation



The Michigan State Bar Foundation provides leadership and grants to improve access for all to the justice system, including support for civil legal aid to the poor, law-related education, and conflict resolution. The Michigan State Bar Foundation was established in 1947 by lawyers and judges to help the legal profession meet its responsibilities to the public. Since then, the Foundation has made more than 1,817 grants totaling over \$180 million to educate the public about the importance of the rule of law, train young people in peaceful conflict resolution and assist those in need with critical civil legal services.

Michigan State Bar Foundation

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About Michigan Community Resources



The mission of Michigan Community Resources is to support and empower nonprofit community-based organizations working in low-income communities, with an emphasis on community and economic development, by providing pro bono legal services and technical assistance. Originally known as Community Legal Resources, we grew from a legal service provider for nonprofits to a comprehensive support organization for low-income communities in Michigan. We provide the legal, community organizing, and urban planning skills and resources that community-based organizations and low-income communities need to revitalize and thrive.

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PREFACE

THANK YOU FOR
READING
“CROWDFUNDING FOR
NONPROFITS: LEGAL
CONSIDERATIONS FOR
501(c)(3) TAX-EXEMPT
ORGANIZATIONS.”

We are glad for your interest and hope this guide assists you in deciding if crowdfunding is right for your organization. Before you read, please be aware of the following comments and limits on the scope of this resource.

This guide was developed in conjunction with several other resources funded by the Michigan State Bar Foundation, including “Crowdfunding & Local Investing” and “Crowdfunding for the Entrepreneur.” This guide is intended to provide information for nonprofit/tax-exempt or social enterprise organizations interested in crowdfunding. Please consider referring to the additional resources available when applicable to your project.

Please be aware that this guide generally focuses on considerations for an organization recognized as tax-exempt under Section 501(c)(3) of the Internal Revenue Code (“501(c)(3)”) that qualifies as a **public charity** under Section 170(b)(1)(A) of the Code, which may be referred to as a **“nonprofit”** or **“tax-exempt”** organization throughout this guide. It does not address legal issues faced by private foundations.

Crowdfunding is a concept that is rapidly changing. There are frequently new resources, tools, laws, and regulations. Similarly, the concepts and rules governing social enterprise and for-profit subsidiaries of nonprofit organizations are changing. No matter how recently you are reading this guide after it is published, we encourage you to do your own research and meet with the crowdfunding, financial, and legal professionals of your choosing.

THIS GUIDE IS NOT LEGAL OR FINANCIAL ADVICE. IT IS MEANT TO BE FOR INFORMATIONAL PURPOSES ONLY.

THE BASICS: CROWDFUNDING AND NONPROFITS

WHAT IS CROWDFUNDING?

Crowdfunding is a capital-raising and fundraising tool allowing a group of people (the “crowd”) to gather their money to invest in and support a cause, project, or business initiated by other people or organizations.

Crowdfunding is rapidly evolving both as a concept and as a tool. Individuals and organizations are increasingly seeking small contributions from a large number of individuals to provide businesses and nonprofits capital to fund everything from art to technological gadgets, real estate developments to community solar projects. Crowdfunding is being used and defined in new ways every day by both funders and recipients.

Crowdfunding is gaining in popularity. Industry analysts estimate that \$16.2 billion was raised globally through crowdfunding in 2014, and they project that number will reach \$34.4 billion in 2015. While crowdfunding is a small portion of the overall investment pie, it is garnering much attention. Growth in crowdfunding is driven by a number of coinciding trends, including changes in information technology, the emergence of social media, and cultural trends favoring local entrepreneurship and production.

Changes in federal and state securities laws have led to greater opportunities for organizations to use crowdfunding not only for donations but also to advertise and solicit investments. Crowdfunding is enabling a shift in how and from whom an enterprise can seek investment. Crowdfunding can open new pools of investors, offer flexibility in lending terms, serve as an opportunity to market organizations, and complement traditional lending tools.

Nonprofit organizations can use some types crowdfunding tools. **But there are several important legal restrictions for nonprofit organizations to be aware of when using crowdfunding.** Please be aware that this guide generally focuses on considerations for an organization recognized as tax-exempt under Section 501(c)(3) of the Internal Revenue Code (“501(c)(3)”) that qualifies as a public charity under Section 170(b)(1)(A) of the Code, which may be referred to as a “nonprofit” or “tax-exempt” organization throughout this guide. It does not address legal issues faced by private foundations. This guide is intended to discuss the two major forms of crowdfunding—donation and investment—and briefly address some of the legal concerns for nonprofits inherent in both.

WHAT ARE THE DIFFERENT TYPES OF CROWDFUNDING?

There are two main categories of crowdfunding: **donation crowdfunding** and **investment crowdfunding**. Crowdfunding, however, is evolving and there are many other ways to think about “types” of crowdfunding. This chart summarizes the differences discussed at greater length below:

TYPE OF CROWDFUNDING	HOW DOES IT WORK?	WHO CAN THE ORGANIZATION ASK TO CONTRIBUTE OR INVEST MONEY?	WHAT DO CONTRIBUTORS RECEIVE IN RETURN?	SUBTYPES/RELATED OR ASSOCIATED TERMS
DONATION CROWDFUNDING	Organization solicits donations from the public for a particular cause, project or business	Any interested individual, business or organization (subject to limits on private inurement and benefit)	A token product or reward and/or the benefit of donating to a project the donor supports	Rewards crowdfunding Civic crowdfunding Crowd-resourcing Pre-selling (in some cases)
INVESTMENT CROWDFUNDING	Business offers to sell an ownership stake in the company or borrow money from investors that will be repaid	Organizations must comply with securities law limits on “publicly advertising” for investment - sometimes that means asking only accredited investors, or only people from Michigan, or only people with whom you have a pre-existing relationship	Investors receive either an ownership stake in the enterprise or the right to receive repayment with interest	Federal crowdfunding Michigan crowdfunding Accredited investor crowdfunding Revenue share crowdfunding Pre-selling (in some cases)

DONATION CROWDFUNDING

“Donation crowdfunding” is a form of fundraising. It involves soliciting outright donations from the public for a venture, such as a cause, project, or business. Subject to limits that apply to other types of fundraising, donation crowdfunding can be used to fund almost any venture. Variants of crowdfunding have been available as a fundraising technique for many years. Crowdfunding has expanded funding opportunities for projects providing community or social benefits with popular support. Nonprofit organizations have also successfully used donation crowdfunding to raise general funds to pay staff and basic operating costs. There are several emerging subtypes of donation crowdfunding.

Rewards or Reward-based Crowdfunding

Rewards or reward-based crowdfunding is a type of donation crowdfunding where people contribute online to an organization or business in exchange for a reward or other specific benefit. For example, businesses might use pre-sales of their products as a reward or a nonprofit might identify a tangible benefit that will be achieved from the donation, such as a meal for a hungry family or a malaria net.

Generally, a rewards crowdfunding campaign where the donor is not motivated by profit and will not be repaid or receive a financial benefit is considered a donation crowdfunding campaign. However, in some cases where the reward has substantial value or the organization is “pre-selling” a product, and the organization is a new organization that might never actually form, there is a possibility that it could be considered investment crowdfunding. Organizations conducting these types of campaigns should review the investment crowdfunding section and be aware of potential securities law implications.

Civic Crowdfunding

Nonprofits and governmental units are using a type of donation crowdfunding called civic crowdfunding to fund public and community projects. For example, in Michigan, the Michigan Economic Development Council and Michigan Municipal League partnered to provide matching funds that crowdfunded projects to activate public spaces and community places. These include a Green Alley project in Midtown Detroit, movies in the park in Tecumseh, and street bump-outs in downtown Traverse City.

Crowd-resourcing

Donation crowdfunding also includes “crowd-resourcing,” where organizations seek not only capital for their projects but also volunteer time, goods, or services. For example, some platforms allow donors to contribute volunteer hours or a needed item (such as a table or chair) at the same time they are donating funds.

Nonprofits should consider several legal issues when pursuing donation crowdfunding. Below is a brief discussion of some of them. Please note that this discussion is not intended to be comprehensive.

Any nonprofit considering donation crowdfunding should consult with a financial or legal professional. Please also note that additional limitations are applicable to nonprofits categorized as "private foundations."

Michigan's Charitable Trust and Solicitation Registration Rules

In Michigan, charitable fundraising is primarily governed by the Charitable Organizations and Solicitations Act, MCL 400.271, et seq. This guide will review the basic requirements for nonprofits based in Michigan under this act.

Just like any other fundraising effort, a nonprofit should ensure it complies with state solicitation requirements before starting a donation crowdfunding campaign. In Michigan, most nonprofits must register with the Michigan Attorney General before soliciting funds from the public and to hold charitable assets. Forms are available online, in the Charities section of the Michigan Attorney General's website (<http://www.michigan.gov/ag>). The registration statement requires information on how the nonprofit intends to solicit funds and whether it will use a professional fundraiser. The Attorney General may register the nonprofit if the registration statement and supporting documentation meet all requirements.

REGISTRATION EXPIRATION AND RENEWAL

The charitable solicitation registration must be renewed annually. Each registration includes its expiration date, which is seven (7) months after the end of the organization's fiscal year. To renew, the organization should submit a Renewal Solicitation Registration Form at least thirty (30) days prior to the expiration date, along with required attachments.

WHAT ARE THE CHARITABLE TRUST AND SOLICITATION REGISTRATION RULES IN OTHER STATES?

A nonprofit soliciting donations from the public must comply with solicitation requirements in every state where it solicits donations or where it seeks donations from residents. Most states require registration, but each state has different rules as to when registration is required. Many require registration before the nonprofit actively seeks donations there.

LEGAL CONSIDERATIONS FOR DONATION CROWDFUNDING CAMPAIGNS

/GLOSSARY TERMS/

Charitable solicitation: A charitable solicitation is any request of any kind for a charitable contribution. In person or telephone, mail or online requests for money and gifts are included in this definition.

Charitable solicitation registration: Fundraising activities are regulated by state law. Most states require charitable nonprofits and any paid professional fundraising staff or consultants carrying out fundraising activities to register with the state before soliciting any donations for any campaign.

WHAT DO THESE RULES MEAN FOR NONPROFIT CROWDFUNDING CAMPAIGNS?

Technically a nonprofit organization should comply with solicitation registration requirements in any state from whose residents it solicits and accepts donations. An online crowdfunding campaign should either restrict from which states it solicits and accepts money or register in all states to pursue a national campaign. Unfortunately, the patchwork of state-by-state solicitation laws can be cumbersome and expensive for nonprofits to comply with in the age of the internet and website fundraising.

There is a joint effort between the National Association of State Charities Officials and the National Association of Attorneys General to create a “Uniform Registration System” for solicitation registration for charities. Information on the filing requirements for each state is located on their website, www.multistatefiling.org. It doesn’t alleviate the need to register with each state but does provide a central database with information on the requirements of each. If a nonprofit is primarily expecting and soliciting funding from residents of a limited number of states where it is registered, it should consider placing a disclaimer on the website or any other solicitation that it is only soliciting donations from residents of those states.

If a nonprofit organization is using donation crowdfunding to “crowd-resource” to raise donations in forms other than cash or volunteer time, the organization should carefully consider which types of donations to accept. Just because someone is willing to donate an item does not mean the nonprofit organization should accept it. The nonprofit organization should have a fundraising policy that addresses this issue, including considerations such as whether the gift fits within the stated mission of the organization; whether it will be difficult to administer or maintain; whether it is too restrictive in purpose; or whether accepting the gift is more for the benefit of the donor than the organization.

Understanding Nonprofit Professional Fundraising Registration and Licensing

In Michigan, a professional fundraiser is a person or entity who “plans, conducts, manages, or carries on a drive or campaign of soliciting contributions” for or on behalf of a nonprofit. Professional fundraisers must register and obtain a license to operate. This registration and licensing must happen before fundraising. Online crowdfunding portals must comply with these registration and licensing requirements.

WHAT DO THESE RULES MEAN FOR NONPROFIT CROWDFUNDING CAMPAIGNS?

A nonprofit organization should ensure that any online crowdfunding portal it uses meets the requirements of the statute. A 501(c)(3) tax-exempt organization should also ensure that any funds paid to the portal are at fair market value determined in an arm’s length transaction and do not run afoul of limits on private benefit or private inurement, discussed in more detail below. **In addition, if a nonprofit is considering running an online campaign from its own website, it should ensure that it has met any registration requirements that might apply.**

Complying with Recordkeeping, Reporting, and Disclosure Requirements

In Michigan, nonprofit organizations using donation crowdfunding must adhere to recordkeeping, reporting, and disclosure requirements. Nonprofits must keep an accurate and detailed record of all documentation filed with the Attorney General because the documents must remain available for public inspection. Copies of all soliciting materials must be provided to the Attorney General upon request.

Fraud, Misrepresentation, and Misleading Conduct

Nonprofit organizations should always strive to ensure their solicitation methods are ethical and honest and encourage donors to give voluntarily, based on their interest and knowledge of the purpose, programs, and achievements of a nonprofit.

Michigan law prohibits nonprofits and portal companies from engaging in any fraudulent, false, or misleading conduct. For example, nonprofit members, portal companies, or others must not represent or imply that a contribution is for a charitable purpose without obtaining written consent from the charitable organization. Nonprofits must not lead others to believe that another person sponsors, endorses, or approves a solicitation if the person has not given written consent to use his or her name. False and misleading statements or misrepresentations about the purpose of the solicitation for funding are prohibited. For a full list of prohibited conduct, see MCL § 400.288.

Violations can be enforced by the Michigan Attorney General, and penalties can be severe. They can include fines, attorney fee awards, and criminal prosecution for knowing violations. The Federal Trade Commission also has authority to pursue penalties against organizations conducting fraudulent donor campaigns.

WHAT DO THESE RULES MEAN FOR NONPROFIT CROWDFUNDING CAMPAIGNS?

Like any other fundraising campaign, nonprofit organizations should strive to be truthful and ethical when seeking donations through crowdfunding. Your organization should clearly state how it intends to use funds in its materials.

For instance, **the crowdfunding nonprofit should think carefully about whether it is seeking unrestricted or restricted funds.** If you are seeking funds to be used for unrestricted tax-exempt purposes, you should clearly state that somewhere in the solicitation, even if specific projects are given as an example of how funds will be used. And if your nonprofit organization is seeking funds for a specific purpose, it is still advisable to include language about how the funds will be used if you can no longer pursue the project or if you raise excess funds.

Some crowdfunding campaigns have been lucky enough to have the problem of raising more funds than could possibly be used for the advertised purpose. These organizations were left in the difficult position of deciding whether they could keep the funds yet still use them in a manner consistent with donor intent. A nonprofit can avoid this problem if the solicitation clearly states how any excess funds will be used. For example, on both the brochure or letter requesting donations, and on the donation acknowledgement, a nonprofit organization could include a statement reserving the right to use the donation in the manner the nonprofit organization determines will best further its 501(c)(3) tax-exempt mission and purposes.

Following 501(c)(3) Tax-Exempt Donor Acknowledgment Requirements

If the donation is tax exempt, **the nonprofit organization should also ensure that it complies with the same donor acknowledgement requirements it would for any other donation.** For any donation, the donor should receive a written communication including: (1) the name of the organization and (2) the date and amount of the contribution. If the contribution is \$250 or more, the communication should also include a description of any non-cash contribution, and either a statement that no goods or services were provided by the organization in return for the contribution or a good faith estimate of the value of any non-token goods or services that an organization provided in return for the contribution. Donors may only claim a deduction to the extent the donation exceeds the fair market value of any non-token goods or services received by the donor in exchange for the contribution. **This is particularly relevant to rewards crowdfunding where the nonprofit offers a good or service directly to donors. In that case, the nonprofit has a duty to disclose the value of the goods and services it is providing.**

It is the donor's responsibility to obtain the written acknowledgment, but it is a good practice for a nonprofit to send the acknowledgment as a matter of course. The written communication to the donor may be by letter or e-mail. To be considered "contemporaneous," the donor should receive it before their tax return is filed, such as by January 31 of the year following the donation.

In addition to the requirements for 501(c)(3) tax-exempt donations, the organization should comply with any internal fundraising and privacy procedures to respect donor privacy. **If the nonprofit organization is soliciting donations online, it is advisable to include a privacy statement explaining the organization's policy for managing donor data.**

Staying Aligned with Organizational Purpose

Organizations that are “organized and operated exclusively” for tax-exempt purposes, including religious, educational, and charitable purposes, are exempt from federal income tax under Section 501(c)(3) of the Code. There are numerous restrictions that apply to 501(c)(3) tax-exempt organizations, including limitations on political activities, **private inurement**, **private benefit**, and unrelated business income tax. This guide will highlight just a few of the restrictions most relevant to investment crowdfunding and its possible effects. The discussion applies only to legal issues relating to public charities, not private foundations.

UNDERSTANDING PRIVATE BENEFIT AND PRIVATE INUREMENT

The limitations on private benefit and private inurement are separate but related, and nonprofit organizations should be mindful of both when planning a crowdfunding campaign. These issues might be more likely to arise in investment crowdfunding campaigns, discussed later in this guide. They are, however, important to keep in mind for donation crowdfunding campaigns as well.

WHAT ARE THE BASIC LIMITS ON PRIVATE INUREMENT?

Under Section 501(c)(3) of the Code and regulations, no part of the net earnings of a tax-exempt organization may inure in whole or in part to the benefit of persons having a personal or private interest in the activities of the organization. In other words, **insiders** cannot use any nonprofit earnings for inappropriate personal gain. “Earnings” is broadly interpreted to include not only profits and distributions, but also benefits accruing through the payment of an above-market interest rate on funds borrowed by an organization, or a below-market interest rate on a loan or lease made by an organization. While this limitation only applies to insiders (which includes an organization’s founders, directors, employees, significant donors, their families, or anyone else who can exercise significant power over the organization or its use of its resources), organizations should be careful that transactions with other persons do not indirectly benefit insiders or violate some other rule, such as the private benefit limitation discussed below.

The penalties for violating the limits on private inurement are severe. In addition to having its tax-exempt status revoked, the organization and its directors, employees, and other insiders may receive significant fines personally and at an organizational level.

WHAT ARE THE BASIC LIMITS ON PRIVATE BENEFIT?

Private benefit is a non-incident benefit that is conferred on a disinterested person in order to serve private interests. Private benefit may include any sort of advantage, profit, privilege, gain, or interest. The limitation on private benefit is similar in concept to private inurement in that its purpose is to ensure that the organization is run exclusively for its tax-exempt purposes; however, it differs in that it applies to everyone, not only insiders, and what qualifies as a benefit is broader than what qualifies as inurement.

While private inurement is strictly prohibited, some private benefit is permitted so long as it is “qualitatively and quantitatively incidental.” The articles of incorporation or the organization must allow no more than an “insubstantial part” of its activities to be for non-exempt purposes. Further, the actual activities of the organization must primarily further tax-exempt 501(c)(3) purposes, with only an insubstantial amount of activities resulting in private benefit.

/GLOSSARY TERMS/

Private inurement: A circumstance where the assets and/or resources of an organization are inappropriately used by people who manage, staff, or fund the organization (insiders) for their own personal benefit, rather than the benefit of the organization. In other words, insiders cannot use any nonprofit earnings for **inappropriate personal gain**. An example of private inurement would be if the Executive Director of a health care nonprofit used a company credit card for personal travel or outings not related to organization’s business.

Private benefit: Private benefit is a non-incident benefit that is conferred on a disinterested person in order to serve private interests. Private benefit may include any sort of advantage, profit, privilege, gain, or interest.

Insiders: An organization’s founders, directors, employees, significant donors, their families, or anyone else who can exercise significant power over the organization or its use of its resources.

HOW DO LIMITS ON PRIVATE INUREMENT AND PRIVATE BENEFIT AFFECT DONATION CROWDFUNDING?

As nonprofits expand into more revenue-generating and social enterprise activity, there may be calls to think or act more like a business. But nonprofit organizations should do so with forethought and caution to ensure that there is no private inurement to insiders; and any private benefit must be truly incidental to achieving the primary tax-exempt purpose. It is important to keep in mind that in many cases, these violations can occur even if the activity is in good faith for a valid tax-exempt purpose.

Whenever a 501(c)(3) nonprofit organization is seeking project donations, through crowdfunding or other means, the organization should ensure that any funds raised do not inure to the benefit of organizational insiders, even if there might be a tax-exempt purpose, and that any private benefit is incidental. Because donors or funders may be treated as insiders if they exert substantial influence over the organization, nonprofits should be careful to ensure that crowdfunding does not lead to private inurement when funds are received from key donors who would financially benefit from the project, and should be cautious of structuring projects in a manner that disproportionately benefits donors over other similarly situated individuals, even if a project is primarily for a tax-exempt purpose.

Understanding Unrelated Business Income Tax

Tax-exempt organizations are generally subject to the **Unrelated Business Income Tax** (“UBIT”) on income generated from non-exempt activities (sometimes called **unrelated business income**, or “UBI”). This means that nonprofits must pay income tax on income from activities that are outside of their tax-exempt purpose. Organizations are encouraged to consult with legal and tax professionals on the specifics of the applicability of UBIT rules to its crowdfunding activities.

WHAT BASIC RULES APPLY TO DETERMINING WHETHER AN ACTIVITY OR INCOME IS SUBJECT TO UBIT?

In general, most tax-exempt organizations pay UBIT on gross income from an “unrelated” “trade or business” “regularly carried on” by the organization.

Any activity may be a “trade or business,” if it consists of the production of income from the sale of goods or the provision of services conducted with a profit motive, regardless of whether profit is achieved. A “trade or business” will be treated as “regularly carried on,” if its frequency and continuity is similar to comparable activities of for-profit entities. For example, an annual seasonal activity could be considered “regularly carried on” if for-profit businesses also generally conduct the business seasonally, such as would occur with the sale of Christmas trees.

A regularly carried on trade or business is deemed “unrelated” to the organization’s exempt purpose, and therefore subject to UBIT, only if the activity is not substantially related to the organization’s tax-exempt purpose. The use of funds generated by an unrelated trade or business to support tax-exempt purposes does not by itself demonstrate a relationship. In other words, even if all the funds from the activity will go toward a charitable purpose, the funds may first be subject to UBIT if the activity generating the funds is not related to the organization’s tax-exempt purposes. An activity is “related” only if there is a substantial causal relationship by which the activity contributes importantly to the accomplishment of the organization’s tax-exempt purposes. Whether an activity is related to the tax-exempt purposes will vary substantially based on the organization, its purposes, and the manner in which the activity is conducted. The size and extent of the activity should be proportional to the activity’s contribution to the organization’s purpose.

There are also a number of significant statutory modifications and exceptions that alter the application of the general rules described above. For example, certain activities may be exempt if all the work is performed by volunteers, if the activity is performed for the convenience of members, or if the income at issue is derived from the sale of donated merchandise. Many forms of “passive income” that are not the product of active competition with for-profit entities, such as dividends, interest, rental income, and revenues from loans of securities, are also exempted from UBIT. Notably, however, there are even some exceptions to these exceptions. For example, passive income generated by a for-profit subsidiary controlled by the nonprofit organization will generally still be subject to UBIT, with the exception of after-tax dividends returned to the nonprofit organization by the subsidiary.

/GLOSSARY TERM/

Unrelated Business Income Tax (UBIT): An organization is granted tax-exempt status because its activities on the whole benefit the public as described by the organization’s charitable purpose. Tax-exempt organizations must pay tax (the UBIT) on any income earned through activities unrelated to the organization’s tax-exempt purpose. This type of income is often called “**Unrelated Business Income**” or **UBI**.

WHAT LIMITS APPLY TO UBI ACTIVITY?

As a general rule, the unrelated activities of an organization should constitute something less than a “substantial” portion of the organization’s overall activities and income. Otherwise, an organization may run afoul of the requirement under Section 501(c)(3) of the Code that it be operated primarily for one or more permissible exempt purposes, which could lead to the revocation of the organization’s tax-exempt status. Whether an unrelated business activity is significant enough to jeopardize the tax-exempt status of an organization is a fact and circumstance specific question. There is no strict percentage rule as to the amount of revenue that may be derived from an unrelated business activity, as there are many other factors considered, such as the amount of time and resources that the organization devotes to the activity, including staff time, and whether the activity, despite being subject to UBIT, is conducted to further the organization’s tax-exempt purposes. It is important for any organization with a sizable unrelated business activity to give special attention to these factors and seek out professional advice to ensure that the activity does not adversely affect its exemption under section 501(c)(3) of the Code.

HOW DO UBIT RULES AFFECT NONPROFIT CROWDFUNDING?

If a nonprofit organization is raising funds through donation crowdfunding in a manner or for an activity that might be considered a trade or business, then the organization must carefully consider whether the activity is also subject to UBIT. This requires evaluating whether it is substantially related to the organization’s mission or, if unrelated, if it is otherwise exempted from UBIT. This might include activities that are not regularly carried on or available only to the organization’s members.

For example, a donation crowdfunding campaign could be considered a trade or business if it includes a reward of substantial value, the pre-sale of a product, or raises money to capitalize the production and sale of a product. If a nonprofit organization conducted a donation crowdfunding campaign to collect funds to develop and sell for profit a product that is unrelated to nonprofit’s mission, it could be subject to UBIT, even if all proceeds from the sale were intended to be used to further the nonprofit organization’s mission.

If the crowdfunding activity could be subject to UBIT, it does not mean that the organization cannot undertake the activity; however, it should ensure that the activity is not a substantial portion of its overall activity. It should also carefully consider whether there might be a better way to raise funds or achieve the same purpose. One option is to conduct the activity through a controlled subsidiary that is a separate organization for tax purposes, which will be discussed at greater length in the investment crowdfunding section below.

Q: *For what types of projects can my nonprofit crowdfund?*

A: It is permissible to crowdfund for a variety of types of projects as long as they align with your organization’s tax-exempt purpose.

Q: *What if the crowdfunding project is not directly related to my organization’s tax-exempt purpose and we successfully raise money from it?*

- Consult an exempt organizations attorney to review your tax-exempt purpose and the law that applies to your circumstance. This area of law is extremely complex and has specific rules.
 - You may have to pay unrelated business income tax on money raised if the attorney determines that the money was not generated from exempt activities.
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HOW DOES INVESTMENT CROWDFUNDING WORK?

Investment crowdfunding allows organizations to raise capital from the public by either:

1. Selling an **ownership** stake (“equity”) in a business to investors; or
2. **Borrowing money** (“debt”) from investors that must be repaid either with a fixed rate of interest or as a percentage of revenue received by the organization.

WHAT IS THE DIFFERENCE BETWEEN INVESTMENT AND DONATION CROWDFUNDING?

Like donation crowdfunding, investment crowdfunding is a collective effort by people to pool their money, often via the Internet, to invest in and support efforts initiated by other people or organizations.

Unlike donation crowdfunding, however, investment crowdfunding includes the issuing of loans or equity in exchange for the investors’ contributions. Since investment crowdfunding involves actual loans or investments, and there is an expectation that persons providing capital will be repaid (perhaps with interest), investment crowdfunding requires compliance with state and federal securities laws.

Investment crowdfunding can work for many organizations, including those seeking long-term investors to start a new venture or expand an established venture where the capital needs are greater. It can also work where other forms of capital raising through banks, friends, and family are no longer sufficient to provide the needed funds. For example, organizations located in communities that do not traditionally attract private development may be able to fund projects by soliciting investment from local businesses, residents, and organizations directly using an online investment crowdfunding portal.

INVESTMENT CROWDFUNDING

/GLOSSARY TERM/

Security: A financial instrument that represents some type of financial value. Securities are typically divided into debt securities and equities. A debt security represents money that is borrowed that must be repaid. Equities represent ownership interest held by shareholders in a corporation.

LEGAL CONSIDERATIONS FOR INVESTMENT CROWDFUNDING

SECURITIES LAWS AND NONPROFIT DONATION CROWDFUNDING

Generally, if a crowdfunding campaign is seeking a donation without a monetary or financial benefit to the donor, it is not subject to securities law. A donation or rewards crowdfunding campaign where the investor will not be repaid or receive a profit will typically not be a "security" under federal or state law.

NONPROFITS AND INVESTMENT CROWDFUNDING

Nonprofits can use many of the same types of crowdfunding as for-profit businesses. But there are a few important additional legal issues that nonprofits must take into account.

A nonprofit may want to use investment crowdfunding for a project that could generate revenue to repay the investment. For example, a nonprofit organization might consider renovating a dilapidated building and renting it out for revenue-generating tax-exempt purposes, such as the provision of affordable housing. Or an environmental nonprofit may be interested in raising funds to enter into a joint venture to support the development of a community solar project.

Nonprofits can use investment crowdfunding to directly support their organization, but there are limitations depending on how the organization will use the funding and how the financing is structured. **A 501(c)(3) nonprofit organization generally will not be able to offer or accept equity investment, but may use debt-based investment crowdfunding as a financing tool.** A nonprofit subsidiary or joint venture, however, might have more flexibility.

Below is a brief discussion of some of the legal issues for nonprofits to consider in pursuing investment crowdfunding. This discussion is a general overview and is not comprehensive. Any nonprofit considering investment crowdfunding should consult with a financial or legal professional on the laws applicable to their organization or project. Please note that additional limitations are applicable to nonprofits categorized as "private foundations." Michigan nonprofit corporations that are not organized as tax-exempt 501(c)(3) organizations will have additional options and considerations.

Securities Laws

Any entity considering investment crowdfunding should be aware of securities laws. It is unlawful to offer or sell a security that does not comply with state and federal law, and an enterprise caught doing so can have severe penalties, such as returning the money that was raised and facing large fines and criminal charges.

Securities law is extremely complex and a detailed discussion of the applicable laws and regulations is outside the scope of the guide. This is a simplified and general overview intended to provide some assistance in understanding and identifying when securities law issues might arise. However, any nonprofit organization considering any type of project involving asking for or receiving investment or loans should consult with an attorney. Please contact Michigan Community Resources to see if your organization qualifies for free legal assistance.

BACKGROUND ON GROWTH OF INVESTMENT CROWDFUNDING: CHANGES IN SECURITIES LAWS

It is essential for organizations doing investment crowdfunding to understand the limits and restrictions imposed by securities laws. Investment crowdfunding has been unavailable to raise capital until recently due to changes in these laws. Federal and “blue sky” state securities laws were developed in the early and mid-20th century to prevent unsophisticated investors from spending their life savings on fraudulent investments that, as a banking official famously stated, were backed by nothing but the blue skies of Kansas. These laws protect investors by creating restrictions and requirements for issuing securities. Now all securities offered or sold must either be registered, or be exempt from registration, with federal or state securities agencies. The registration requirements can be expensive and complicated, depending on the circumstance.

Because of these laws, it was generally unlawful for most businesses to simply ask for loans or investment from the general public. An organization that wanted to raise capital through the sale of its equity or debt could not use the internet or social media to find investors. Most “capital raises” funding businesses were limited to **accredited investors**. Non-accredited investors had limited opportunity to participate in such capital raises. Most alternative ways to raise capital involved prohibitively expensive and complicated registration with state or federal government agencies.

In 2012, the U.S. Congress passed the Jumpstart Our Business Startups Act (“JOBS Act”), which created new exemptions from state and federal securities laws. This made it easier to publicly advertise for investment from accredited investors, and importantly, it created a new registration process to advertise for investment opportunities publicly online (crowdfunding). The federal crowdfunding registration process is dependent on the Securities and Exchange Commission (SEC) adopting regulations to implement the law. This is expected in late 2015.

In the meantime, many states have stepped in to fill the gap by adopting intrastate investment crowdfunding laws. Michigan was one of the first, adopting the Michigan Invests Locally Exemption (the “MILE”), which enables Michigan crowdfunding. Under MILE, the issuer must be a Michigan entity, it can only offer investment opportunities to Michigan residents, and all investors must be Michigan residents. In addition to intrastate investment crowdfunding laws, organizations and entities are conducting crowdfunding campaigns relying on other types of securities law registrations and exemptions that were not designed solely for that purpose but may be a good fit depending on the project.

/GLOSSARY TERM/

Accredited Investors include each of the following:

- Individuals with a net worth of \$1 million, excluding his or her residence
- Officers and directors of the company or organization seeking investment and certain entities with more than \$5 million in assets
- Individuals with an income of \$200,000 a year (or \$300,000 for married couples)

MILE Act

THE BUSINESS IS A
PRIVATE MICHIGAN
ENTITY

ALL INVESTORS ARE
MICHIGAN
RESIDENTS

THE BUSINESS
ONLY OFFERS THE
INVESTMENT
OPPORTUNITY TO
MICHIGAN
RESIDENTS

WHAT DO SECURITIES LAWS MEAN FOR NONPROFIT CROWDFUNDING?

Like any other entity, a nonprofit's security must comply with an exemption from securities law or be registered with both the appropriate state and federal agency. In general, nonprofit organizations otherwise complying with restrictions applicable to a 501(c)(3) organization have the ability to use the same registration or exemptions as any other entity. For more detail on these options, organizations can refer to the Crowdfunding for the Entrepreneur Guide. There are also additional exemptions and registrations available only for nonprofit organizations at both the state and federal levels.

Federal law largely exempts securities issued by organizations organized and operated exclusively for 501(c)(3) purposes and not-for-profit, and without private inurement or benefit. Note that not every security is exempt simply because it is issued by a 501(c)(3) organization; it must also meet the applicable restrictions on private benefit and inurement, which means nonprofit securities might still be subject to federal registration depending upon their structure and purpose and to whom they are offered. The security must be structured to have terms that are fair market value or more favorable for the nonprofit organization. In addition, nonprofit organizations issuing securities should always ensure they are in compliance with other potentially applicable laws, such as the federal Trust Indenture Act of 1939, which generally applies to securities issued by 501(c)(3) organizations under the federal exemption.

Michigan also has special exemptions for nonprofit organizations organized and operated for 501(c)(3) tax-exempt purposes and not for pecuniary profit, where no part of the net earnings inures to the benefit of a private stockholder or other person. For such organizations, there is a self-executing exemption for the registration of debt securities that are part of an issue that has an aggregate sale price of \$500,000 or less and is sold to bona fide members of the issuing organization without payment of a commission or consulting fee. Since most investment crowdfunding campaigns seek capital from the general public (and not just bona fide members) this exemption may not be the best fit for many projects.

In all cases, nonprofit organizations considering investment crowdfunding should consult with an attorney because the applicable rules are complex and projects should be carefully structured to comply with applicable rules. Please contact Michigan Community Resources to see if your organization qualifies for free legal assistance.

Tax-Exempt Purpose Limitations: UBIT, Private Benefit, and Private Inurement

Any investment crowdfunding project should be structured to comply with the purpose limitations on a 501(c)(3) organization discussed in the section on donation crowdfunding, including the restrictions on private benefit inurement and UBIT. These restrictions should be carefully considered and understood by any nonprofit organization considering investment crowdfunding, including seeking legal advice on the applicability of the restrictions to their project.

WHAT DO PURPOSE LIMITATIONS MEAN FOR INVESTMENT CROWDFUNDING?

Like any other activity of a 501(c)(3) nonprofit organization, investment crowdfunding must comply with limits on private inurement and benefit, including UBIT concerns. The interest rates and terms of the investment should be set at arm's length, or, ideally at terms that are better than fair market value for the organization. If not, the payments received by the investor could be considered private benefit. If an investor is given substantial influence over the use of the funds, the investor could be considered an "insider" subject to private inurement limitations.

In general, activities funded through a crowdfunding campaign should fit within the organization's charitable purposes and should provide no more than incidental private benefit.

UBIT AND INVESTMENT CROWDFUNDING

In cases where tax-exempt organizations may want to crowdfund money to help finance or support revenue-generating activities, it should consider the potential effects of UBIT. The most basic effect is that the organization will need to account for UBI in its financial planning for the project. However, UBIT rules are also an important consideration in determining the best legal and financial structure for the activity. They should be considered when determining whether to conduct the activity directly or through a joint venture, a subsidiary, or other form. They might also affect the best structure for the crowdfunding investment from a legal and financial perspective. Most importantly, organizations need to ensure that any UBI activities do not rise to the level of being a substantial part of their activity that threatens their tax-exempt status.

Because of the complexity of the rules in this area, it is important to seek out the advice of a qualified attorney or tax professional to determine whether the activity is subject to UBIT and the best way to structure the project.

PRIVATE BENEFIT, PRIVATE INUREMENT, AND JOINT VENTURES

Nonprofit organizations should be particularly careful of private inurement and benefit limits when entering into joint ventures with for-profit entities or operating through a for-profit subsidiary that is not wholly-owned and controlled by the nonprofit organization. The IRS may recognize a "joint venture" even in circumstances where there is no formal or written agreement between the for-profit and nonprofit entity. Such recognition could cause the IRS to impute the activities of a for-profit to the nonprofit organization. These relationships and the tax and legal rules governing them are highly complex. Consult with an experienced attorney if you are considering using investment crowdfunding in a joint venture or with a for-profit subsidiary. Contact Michigan Community Resources to see if you qualify for free legal assistance.

A NOTE ON NONPROFIT SUBSIDIARIES

One approach to conduct investment crowdfunding in a manner consistent with applicable 501(c)(3) purpose limitations is to create a subsidiary wholly owned or controlled by the nonprofit organization to conduct the activity.

A nonprofit organization can create a subsidiary that is treated for tax purposes as either (a) a disregarded entity, such as a single-member/owner limited liability company or other partnership, or (b) a separate entity, such as a c-corporation or multi-member limited liability company. If a subsidiary is a “disregarded entity,” the IRS will view the activities of the subsidiary to be the activities of the nonprofit organization, and all the same restrictions will apply to the subsidiary’s activities that apply to the nonprofit’s activities.

If the nonprofit creates the subsidiary as a separate entity for tax purposes, then its activities are not viewed as activities of the 501(c)(3) organization if certain restrictions are followed. For example, the subsidiary cannot be a mere extension of the nonprofit organization and must undertake independent, bona fide functions. In general, this requires having separate boards, although overlapping boards is permissible, and the nonprofit organization’s staff and board should not directly manage the subsidiary’s day-to-day operations. The subsidiary board should be a bona fide body that holds regular meetings, makes decisions, and keeps meeting records. The nonprofit organization and the subsidiary may share resources such as office supplies, facilities, employees, etc. However, all relevant costs should be allocated on the basis of actual use and each organization should pay fair market value for use of the supplies.

Even if the for-profit subsidiary is treated as a separate organization for tax purposes, there are still limits on its activities. In addition to the limits discussed above, to the extent the subsidiary takes resources of the nonprofit organization, including staff or other shared resources, then the nonprofit’s participation must comply with restrictions on private inurement and benefit and UBIT. Generally the subsidiary’s activities supported by the resources of the 501(c)(3) organization must either further the 501(c)(3) organization’s tax-exempt purposes, with only incidental private benefit (which is easier to demonstrate if the 501(c)(3) organization retains control over the subsidiary and retains power to veto subsidiary actions that would be contrary to its 501(c)(3) tax-exempt status); or be an insubstantial part of the nonprofit organization’s activities. Moreover, the nonprofit organization’s income from subsidiary activities may be subject to UBIT, which is in turn subject to the limits discussed in this guide. Special rules apply to UBIT where the income is from a subsidiary and they vary depending on whether the subsidiary is “controlled” by the 501(c)(3) organization. Notably, however, the profits of a subsidiary controlled by the nonprofit organization that are returned to the nonprofit organization as after-tax dividends are not subject to UBIT, even if generated by activity unrelated to the nonprofit organization’s mission.

A nonprofit organization’s subsidiary could use crowdfunding to raise money for its activities. To the extent the nonprofit organization is involved in organizing or running the crowdfunding campaign, even if the campaign raises funds for a project consistent with 501(c)(3) purposes, the nonprofit organization should ensure its involvement and any compensation it receives for its participation is consistent with the limits discussed in this section. Organizations should refer to the Crowdfunding for the Entrepreneur Guide and speak to an experienced attorney for more details on applicable securities law related to these crowdfunding options.

Let's see how a nonprofit might begin preparing for a crowdfunding campaign.

Case Study: Real Good Deeds Nonprofit Corporation Donation Crowdfunding Campaign

Real Good Deeds is a 501(c)(3) nonprofit organization established in Michigan. Real Good Deeds offers after school programs in the Detroit area. Most of the individuals who participate in their programs are teenagers and young adults who live below the poverty line. Real Good Deeds serves about 1,000 people per year and the number is growing.

The organization conducts all of its services in a medium-sized building located on Detroit's Eastside. There is a mixture of commercial and residential property in the immediate vicinity, with an elementary and high school just two blocks away. Real Good Deeds wants to expand its services to include adult education, job training, work programs, parenting resources, adult education, craft and trade workshops, and other programs in Detroit. Many people have expressed interest in volunteering to provide these services, and several businesses are on board as well.

To that end, Real Good Deeds wants to develop a community center. The center would include a small library and computer room; gymnasium; meeting, study and conference rooms; cafeteria; outdoor playground; picnic areas and other amenities. The center would provide several benefits to local neighborhood communities and many local residents want to support the community center development.

There is a large building across the street from Real Good Deeds' current location that used to be an elementary school. Years ago, an investor purchased several properties in the neighborhood, including the old school. The owner is aware of Real Good Deeds' community development plans and has expressed interest in selling the building. It will cost them approximately \$100,000 to purchase the property. Real Good Deeds does not have the funds for this project, but has heard a lot about crowdfunding and wants to utilize this financing method.

HOW DOES A NONPROFIT CROWDFUNDING CAMPAIGN WORK IN ACTION?

Real Good Deeds Consults with an Attorney

After weeks of research and conversations, the Board of Trustees has agreed to use donation crowdfunding to help finance the community center project. They have spoken to several vendors and service professionals about the project. The Board has even identified an online portal company geared towards the purchase of real estate through crowdfunding. Before officially taking the plunge into crowdfunding, the Board decided to contact Michigan Community Resources to find an attorney to help.

The attorney explained the different crowdfunding concepts and advised them of the legal considerations. The Board learned about the risks involved in using crowdfunding for the community development center project.

Real Good Deeds obtained the registration application materials that it must submit to the Michigan Attorney General's Office before soliciting funds online. Among other things, Real Good Deeds must disclose the purpose of the funding solicitation and how it intends to solicit funding. Real Good Deeds must keep copies of all supporting documents required to be filed with the state and make them available for public inspection upon request.

Because Real Good Deeds was seeking funds from many states online it referred to **www.multistatefiling.org**. There it learned about the various state requirements for charitable solicitation.

Real Good Deeds will next have to determine whether the online portal it identified to facilitate the funding campaign is in compliance with Michigan's professional fundraising rules before engaging their services. The online portal must also be registered, licensed and otherwise in compliance with Michigan law as a professional fundraiser. A fundraiser's failure to comply with Michigan's fundraising rules may prevent them from operating in Michigan and subject Real Good Deeds and the online portal company to other penalties.

In addition, the attorney informed Real Good Deeds about conduct prohibited by Michigan law regarding its solicitation of funds. Among several other activities expressly stated in Michigan law, Real Good Deeds was advised not to disseminate any false or misleading information to the public regarding the crowdfunding campaign and community development center project. False, misleading, fraudulent conduct or information, Real Good Deeds learned, can lead to civil and/or criminal prosecution by the Michigan Attorney General. Real Good Deeds must also ensure that all of its intended funds from the crowdfunding campaign will be used for Real Good Deeds' 501(c)(3) tax-exempt purpose or risk losing its tax-exempt status.

Given all of the rules and regulations related to donation crowdfunding, Real Good Deeds worked with the attorney, who advised them throughout the crowdfunding process to avoid penalties and reduce the legal risks.

National Crowdfunding Platforms

Patronicity	https://www.patronicity.com/
RocketHub	https://www.rockethub.com/
CauseVox	http://www.causevox.com/
Razoo	https://www.razoo.com/
Kickstarter	https://www.kickstarter.com/
Indiegogo	https://www.indiegogo.com/
IOBY	https://www.ioby.org/

Michigan-based Crowdfunding Platforms

LocalStake	https://localstake.com/
Michigan Funder	http://michiganfunders.com/
Fundrise	https://fundrise.com/

Michigan Resources for Local Investing

Local Investing.com	https://www.local-investing.com
Locavesting.com	https://www.locavesting.com
Revalue Investing	https://www.revalueinvesting.com
Crowdfunding Michigan	https://www.crowdfundingMI.com
Sidewalk Ventures	http://www.sidewalk-ventures.com
Public Spaces, Community Places	https://www.patronicity.com/puremichigan

Due Diligence Checklist & Request Template

Go 4 Funding Due Diligence Checklist

<http://www.go4funding.com/Articles/Angel-Investors/Due-Diligence-Checklist.aspx>

The Venture Alley Due Diligence Request Template

<http://www.theventurealley.com/files/2013/08/Form-of-Due-Diligence-Request-short-form.pdf>

CROWDFUNDING RESOURCES AND LINKS

**Listing of these sites does not constitute an endorsement of any of the content included within.*

CROWDFUNDING RESOURCES AND LINKS

**Listing of these sites does not constitute an endorsement of any of the content included within.*

National Investor Networks

Slow Money

<https://www.slowmoney.org/>

Angel Investor Networks for Accredited Investors Only

Grand Angels (West Michigan)

<http://www.grandangels.org>

Ann Arbor Angels

<https://www.annarborangels.org>

Bluewater Angels (Midland)

<https://www.bluewaterangels.org>

Michigan Women's Foundation

<https://www.miwf.org>

Resource Links to Find Investor Groups

Michigan Venture Capital Association

<http://www.michiganvca.org/>

Angel Capital Association

<http://www.angelcapitalassociation.org/>

State of Michigan Resources (LARA)

Issuing and Investing In Securities through Crowdfunding: Frequently Asked Questions

http://www.michigan.gov/lara/0,4601,7-154-61343_32915_59944-289603--,00.html

LARA Tips on Intrastate Equity Crowdfunding

<http://www.michigan.gov/lara/0,4601,7-154--352390--,00.html>

LARA Crowdfunding - Things to Keep In Mind

<http://www.michigan.gov/lara/0,4601,7-154--352390--,00.html>

Michigan Invest Locally Exemption (MILE) Resources

Registered Crowdfunding Portals

http://www.michigan.gov/lara/0,4601,7-154-61343_32915_59944-319233--,00.html

Checking on a Company/Business Entity Search

http://www.dleg.state.mi.us/bcs_corp/sr_corp.asp

CROWDFUNDING GLOSSARY

Accredited Investor: A director, executive officer, or general partner of the company selling the securities (and seeking investment); or a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, excluding the value of the primary residence of such person; or a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year.

Capital: Funds contributed by an individual, particularly an investor, for the purpose of maintaining or expanding a business enterprise.

Charitable solicitation: A charitable solicitation is any request of any kind for a charitable contribution. In person or telephone, mail or online requests for money and gifts are included in this definition.

Charitable solicitation registration: Fundraising activities are regulated by state law. Most states require charitable nonprofits and any paid professional fundraising staff or consultants carrying out fundraising activities to register with the state before soliciting any donations for any campaign.

Crowdfunding Platform: Online system which provides information about projects seeking funding and possesses the ability to aggregate funds for investment into these projects.

Debt Interest: The right to repayment after a sum has been loaned, usually with a fixed or variable rate of interest.

Disclosure: Providing pertinent information, used for investment decision making, by a company to investors.

Distribution: An allocation of profits based on ownership percentage.

Due Diligence: Research performed on a business entity to evaluate its potential as an investment; "due diligence" includes reviewing financial statements, pending litigation, and discussions with management to assess the long-term viability of the business.

Equity Interest: A stock or any other security representing an ownership interest.

Federal Crowdfunding: Raising capital, typically small amounts from a large group of contributors, through either a registered broker-dealer or a registered funding portal, with corresponding limits on both the amount any individual investor can contribute and the amount a company can raise.

Insiders: An organization's founders, directors, employees, significant donors, their families, or anyone else who can exercise significant power over the organization or its use of its resources.

Investment: Funds allocated for a particular business purpose, particularly growth or expansion, with the expectation or hope that the funds will increase in value.

CROWDFUNDING GLOSSARY

MILE Act: The Michigan Invests Locally Act or MILE is legislation that allows companies to raise capital if they meet certain criteria including: The business is incorporated in Michigan to sell securities in its business to Michigan investors, individuals who have a principal residence or business organizations with a principal office in Michigan, without having to register its securities. A business may accept up to \$10,000 from a single investor, unless the investor is an accredited investor and if so, the business may accept more than \$10,000 from the accredited investor and is able to raise up to \$1 million in 12 months without providing audited financial statements or reviewed financial statements to a prospective investor for the business's most recently completed fiscal year, prepared by a certified public accountant. A business may raise up to \$2 million in 12 months if it provides a prospective investor audited financial statements or reviewed financial statements for the business's most recently completed fiscal year prepared by a certified public accountant.

Non Accredited Investor: An investor who does not meet the requirements of an Accredited Investor.

Ownership Stake: The proportion of a business owned by an investor which is usually accompanied by economic and other legal rights.

Private benefit: Private benefit is a non-incident benefit that is conferred on a disinterested person in order to serve private interests. Private benefit may include any sort of advantage, profit, privilege, gain, or interest.

Private inurement: A circumstance where the assets and/or resources of an organization are inappropriately used by people who manage, staff, or fund the organization (insiders) for their own personal benefit, rather than the benefit of the organization. In other words, insiders cannot use any nonprofit earnings for **inappropriate personal gain**. An example of private inurement would be if the Executive Director of a health care nonprofit used a company credit card for personal travel or outings not related to organization's business.

Registered Online Portal: An online medium for the purpose of crowdfunding registered with the appropriate state or federal authorities.

Risk: The possibility of economic loss attached to owning a security; "risk" also generally encompasses the pitfalls and challenges associated with running a business operation.

Security: A financial instrument that represents some type of financial value. Securities are typically divided into debt securities and equities. A debt security is a type of security that represents money that is borrowed that must be repaid. Equities represent ownership interest held by shareholders in a corporation.

Shares: Ownership interest by an investor in a business entity.

USA JOBS Act: Legislation passed in 2012 by the US Congress that permits the general solicitation of investment opportunities through crowdfunding internet portals and subsequently provides greater opportunities for non-accredited investors to participate in investment opportunities.

U.S. Securities and Exchange Commission (SEC): An agency of the United States federal government that holds primary responsibility for enforcing the federal securities laws, proposing securities rules, and regulating the securities industry.

Unrelated Business Income Tax (UBIT): An organization is granted tax-exempt status because its activities on the whole benefit the public as described by the organization's charitable purpose. Tax-exempt organizations must pay tax (the UBIT) on any income earned through activities unrelated to the organization's tax-exempt purpose. This type of income is often called "**Unrelated Business Income**" or **UBI**.