ORIGINAL RESEARCH PAPER

Management

# LEGAL STATUS OF CROWDFUNDING IN INDIA: A QUALITATIVE ANALYSIS OF A FRAGMENTED REGULATORY FRAMEWORK

**KEY WORDS:** crowdfunding, SEBI, RBI, Companies Act 2013, peer-to-peer lending, equity crowdfunding, India, financial regulation

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**ABSTRACT**

Crowdfunding has emerged globally as a significant alternative financing mechanism, enabling entrepreneurs, non-profits, and individuals to raise capital directly from a distributed pool of contributors via online platforms. In India, however, its legal treatment remains fragmented, governed not by a single consolidated statute but by an overlapping patchwork of securities law, banking regulation, company law, and tax law. This paper adopts a qualitative, doctrinal legal research approach to examine the regulatory status of India's four principal crowdfunding models: donation-based, reward-based, peer-to-peer (P2P) lending, and equity-based crowdfunding. Drawing on statutory provisions, regulatory circulars, enforcement actions, and case law, including the Securities and Exchange Board of India's (SEBI) 2014 consultation paper, the Reserve Bank of India's 2024 amendments to the P2P Master Directions, and the Supreme Court's Sahara ruling, the study finds that donation- and reward-based crowdfunding operate in a largely unregulated space, P2P lending is subject to increasingly stringent RBI oversight, and equity crowdfunding remains functionally prohibited under securities law despite the absence of an explicit statutory ban. The paper argues that this regulatory fragmentation reflects an unresolved tension between investor protection and capital-access objectives within India's financial governance architecture, and it concludes with policy recommendations toward a more harmonized, calibrated crowdfunding framework.

## 1. INTRODUCTION

Crowdfunding, raising small sums of capital from many contributors, typically via online platforms, has become a significant alternative financing channel worldwide. In India it funds medical emergencies, creative projects, social causes, small loans, and, more controversially, startup equity. Yet India has no single, consolidated crowdfunding statute; each variant is governed, or left ungoverned, by a different combination of securities law, banking regulation, company law, and tax law. This paper qualitatively examines that fragmented landscape, asking how Indian law treats each crowdfunding model and what this fragmentation reveals about India's regulatory philosophy toward alternative finance.

## 2. METHODOLOGY

This study uses doctrinal legal research combined with qualitative thematic analysis of regulatory commentary. Primary sources include the Companies Act, 2013; RBI Master Directions on NBFC-P2P lending; SEBI's statements and 2014 consultation paper; the Income Tax Act, 1961; and the Foreign Contribution (Regulation) Act, 2010. These are read alongside the Sahara precedent and recent (2023–2026) practitioner commentary to trace how enforcement has evolved. The analysis proceeds model-by-model, mirroring how Indian regulators themselves treat crowdfunding, as discrete financial activities sharing a common technology rather than a unified phenomenon.

## 3. Legal Framework by Crowdfunding Model

### 3.1 Donation-based and Reward-based Crowdfunding

Donation-based platforms (e.g., Milaap, Ketto) and reward-based platforms (e.g., Wishberry) occupy the most permissive corner of Indian crowdfunding law and are commonly used for social initiatives via platforms such as Milaap, Fuel-a-Dream, Range De, and Bitgiving. Neither SEBI nor the RBI regulates these models directly; they operate under general contract law and, where a company is involved, ordinary disclosure norms.

Two collateral concerns remain. First, contributions exceeding ₹50,000 from non-relatives can attract tax liability under Section 56(2)(x) of the Income Tax Act, 1961, as "income from other sources" unless exempted. Second, campaigns receiving foreign contributions may require FCRA registration, since unregistered receipt of foreign funds by Indian entities, particularly non-profits, is restricted.

### 3.2 Peer-to-Peer (P2P) Lending

P2P lending is the most heavily regulated crowdfunding model. The RBI brought P2P platforms within the NBFC perimeter via a 2017 notification, with Master Directions requiring registration, lender-exposure caps, and disclosure. Lenders' aggregate exposure across all NBFC-P2P platforms is now capped at INR 5 million.

The regime tightened after supervisory findings of misconduct: on 16 August 2024 the RBI revised the Master Directions in response to platforms bypassing the prescribed funds-transfer mechanism and marketing P2P lending as an investment product. Platforms are now barred from offering credit enhancement or guarantees, losses fall solely on lenders, and must maintain segregated escrow accounts, disclose borrower NPA data, and display revised risk caveats. This marks a shift from treating P2P platforms as passive marketplaces to accountable financial intermediaries.

### 3.3 Equity/Securities-Based Crowdfunding

Equity crowdfunding is the most contested category. In 2016, SEBI declared digital equity crowdfunding platforms illegal under the Securities Contracts (Regulation) Act, 1956, reasoning that open electronic solicitation breaches both securities law and the private placement framework under the Companies Act.

That framework, Section 42 of the Companies Act, 2013, restricts private placement to persons specifically identified by the board, capped at 200 persons per class of security per year, with no public advertisement. Breach converts the offer into a deemed public offer, triggering the Companies Act, SCRA 1956, and SEBI Act 1992. Since crowdfunding platforms solicit indeterminate retail investors openly, they structurally violate these conditions. The Ministry of Corporate Affairs has enforced this directly, clarifying that companies cannot use crowdfunding platforms to issue securities in violation of Section 42. The Supreme Court's Sahara ruling, ordering refunds of roughly ₹17,400 crore after mass solicitation bypassed Section 42, remains the doctrinal backdrop for this caution.

### 3.4 SEBI's Position and the Impact of the Equity Crowdfunding Ban

SEBI has never passed a formal regulation banning equity crowdfunding; the prohibition operates through interpretation and public warning. Its notice, declaring platforms "unauthorised, unregulated and illegal", was criticized by industry as vague, leaving platforms uncertain of their exposure. Penalties for unregistered public solicitation of shares can include fines up to ₹25 crore and criminal prosecution.

SEBI's only substantive reform attempt was a June 2014 Consultation Paper proposing eligibility for startups under 48 months old, a ₹10 crore/issuer annual cap, participation restricted to accredited investors (net worth above ₹2 crore or income above ₹25 lakh), and mandatory platform registration. It was never enacted. Critics argued the accredited-investor restriction defeated the purpose of "crowd" funding, while regulators cited fraud risk and supervisory difficulty. As of 2026, no further regulation has followed.

The ban's effect has been displacement rather than elimination. Platforms such as AngelList and LetsVenture re-registered as SEBI Alternative Investment Funds, shifting to closed, curated investor pools with higher compliance burdens that price out smaller entrants. Some startups used Compulsorily Convertible Debentures to sidestep Section 42, but the Registrar of Companies has since penalized this route. A 2017 government proposal to exempt crowdfunding under Companies Act Section 462 also did not materialize. Table 1 summarizes the legal status of each model, and Table 2 traces the equity-crowdfunding regulatory timeline.

**Table 1. Crowdfunding Models and Their Legal Status in India**

| Model | Legal Status | Governing Law / Regulator |
|---|---|---|
| Donation-based | Legal, largely unregulated | General contract law; FCRA (if foreign donors); Income Tax Act §56(2)(x) |
| Reward-based | Legal, largely unregulated | Consumer protection / contract law |
| Peer-to-peer (P2P) lending | Legal, tightly regulated | RBI Master Directions, 2017 (amended August 2024) |
| Equity / securities-based | Effectively illegal / unauthorized for retail platforms | SEBI position under SCRA 1956; Companies Act 2013 §42 (private placement) |

**Table 2. SEBI's Regulatory Timeline on Equity Crowdfunding and Market Response**

| Year | SEBI / Regulatory Action | Market / Industry Response |
|---|---|---|
| 2014 | SEBI releases Consultation Paper proposing equity crowdfunding for accredited investors only; ₹10 crore/issuer cap | Mixed industry reaction; criticized for excluding retail "crowd" participation |
| 2014–2015 | Consultation paper not converted into binding regulation | Equity crowdfunding platforms (AngelList, LetsVenture, Tracxn Labs, Equity Crest) continue operating in a regulatory grey zone |
| 2015–2016 | SEBI declares digital equity crowdfunding platforms "unauthorised, unregulated and illegal" under SCRA 1956 | Platforms report the notice as vague/"overbearing" ;donation/reward platforms (Ketto, Catapoolt) also unsettled by association |
| Post-2016 | SEBI notices push platforms toward compliance | Major platforms re-register as SEBI Alternative Investment Funds (AIFs), shifting to closed, curated investor pools |
| ~2017 | Reported government discussion of exempting crowdfunding under Companies Act §462 | Proposal does not materialize into an enacted exemption |
| Ongoing | Some issuers use Compulsorily Convertible Debentures (CCDs) as a workaround to §42 restrictions | Registrar of Companies penalizes CCD-route companies, closing off the workaround |
| 2014–2026 | No updated consultation paper, circular, or regulation issued by SEBI | Equity crowdfunding remains a de facto prohibition for open retail platforms; AIF route becomes the only viable structure |

India has not banned equity crowdfunding by name, but Section 42's private-placement ceiling, SEBI's SCRA-based interpretation, and a decade of regulatory inaction together produce a de facto prohibition for retail-facing platforms. The market response, consolidation into SEBI-registered AIF structures for high-net-worth investors, closely resembles what the 2014 consultation paper itself proposed, just achieved through market adaptation rather than regulation.

## 4. DISCUSSION

Three qualitative themes emerge. First, fragmentation is the policy default: banking-like activity (P2P) falls to the RBI, securities-like activity (equity) falls to SEBI/MCA, and everything else falls into a gap addressed only incidentally by tax and foreign-contribution law, producing uneven investor protection that is strong in P2P but minimal in donation-based models, where fraud risk is arguably comparable.

Second, there is a persistent asymmetry between innovation and caution. Despite donation- and reward-based platforms having raised over ₹3,000 crore since 2014, the securities regulator has not formalized equity crowdfunding, even as the UK's FCA regime and the US JOBS Act's Regulation Crowdfunding demonstrate calibrated frameworks with investor caps and platform licensing. India's inaction forecloses a legitimate financing route for early-stage ventures lacking venture-capital access.

Third, enforcement is reactive rather than architectural: the 2024 P2P amendments and the MCA's crowdfunding order both responded to observed misconduct rather than a pre-designed framework, leaving founders and platforms in continuous legal uncertainty, particularly at the equity-crowdfunding/private-placement boundary.

## 5. CONCLUSION AND RECOMMENDATIONS

Crowdfunding's legal status in India is best understood as a matrix rather than a single answer: donation- and reward-based models are legal but under-regulated; P2P lending is legal and increasingly tightly regulated; and equity crowd-funding remains effectively prohibited for retail-facing platforms. Regulators should (a) finalize a calibrated equity crowdfunding framework building on SEBI's dormant 2014 proposal, with investor caps, platform licensing, and man-datory disclosure; (b) introduce baseline disclosure and fraud-prevention norms for donation-based platforms given their scale; and (c) issue consolidated guidance on the Section 42/crowdfunding-platform interface to reduce compliance ambiguity. Absent reform, India's crowdfunding sector will likely keep growing unevenly, vibrant in donation and P2P lending, structurally blocked in equity crowdfunding.

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