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The Promised Land is on the Horizon: The Fix Crowdfunding Act Will Implement Small Changes That Could Make a Big Impact on Investors and Businesses Alike

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THE PROMISED LAND IS ON THE HORIZON: THE FIX CROWDFUNDING ACT WILL IMPLEMENT SMALL CHANGES THAT COULD MAKE A BIG IMPACT ON INVESTORS AND BUSINESSES ALIKE

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I. INTRODUCTION

Small businesses[1] have a large impact on the American economy.[2] The 28 million small businesses in America account for 54% of all U.S. sales.[3] Small businesses have comprised 66% of all new U.S. jobs since the 1970s.[4] The ability for small businesses to thrive is imperative to the livelihood of millions of Americans.

Given those statistics, it is daunting that new business startups in this country are at a twenty-year low.[5] Statistically speaking, most businesses fail due to a lack of capital.[6] Therefore, Congress enacted the Jumpstart Our Business Startups Act of 2012 (the JOBS Act) to exempt the long and costly SEC filings and to enable businesses to raise more capital.[7]

The JOBS Act promised to fix these issues and offer equity investments to everyone, not just the super wealthy.[8] But not all was created equal within the JOBS Act. The best opportunities are still left to a small percentage of Americans, while other eligible investors are subjected to high regulations and costs.[9] These excessive costs are passed on to small businesses and unaccredited investors who cannot afford to bear them.[10] These one-sided regulations and high costs have effects that were not intended by Congress, and it is important to businesses and investors alike that they are amended quickly.

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[1] Small businesses are defined as enterprises with 500 employees or less. *Frequently Asked Questions About Small Business*, U.S. SMALL BUS. ADMIN. (Aug. 2017), https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2017-WEB.pdf.

[2] *Small Business Trends*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/managing-business/running-business/energy-efficiency/sustainable-business-practices/small-business-trends (last visited Jan. 28, 2018).

[3] *Id.*

[4] *Id.*

[5] Fix Crowdfunding Act, H.R. 162, 114th Cong. 4236, 4237 (as passed by the House, July 05, 2016).

[6] Sara Hanks & Andrew Stephenson, *Online Securities Offerings*, 33 BANKING & FIN. SERVS. POL'Y REP., Feb. 2014, at 1.

[7] Armstrong Teasdale LLP., *JOBS Act Eases Regulatory Burdens on Capital Raising*, NAT'L L. REV. (Apr. 18, 2012), http://www.natlawreview.com/article/jobs-act-eases-regulatory-burdens-capital-raising.

[8] *See, e.g.*, 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) ("Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace."); 157 CONG. REC. H7295-01 (daily ed. Nov. 3, 2011) (statement of Rep. Patrick McHenry) ("[H]igh net worth individuals can invest in businesses before the average family can. And that small business is limited on the amount of equity stakes they can provide investors and limited in the number of investors they can get. So, clearly, something has to be done to open these capital markets to the average investor . . . .").

[9] *Id.*

[10] *Id.*

Thus far, crowdfunding has mainly consisted of unfulfilled promises, and it is time to do something about it. With the proposed Fix Crowdfunding Act that has passed in the House of Representatives and is now awaiting review of the Senate, the promised land of crowdfunding for all, with low costs and reasonable regulations, could finally be a reality for millions of investors and business owners. This Comment will discuss why these amendments are imperative for crowdfunding to be successful.

Until the Fix Crowdfunding Act is in effect, it is important that business owners and investors take caution. It is crucial that business owners and investors understand the various risks and understand how to maximize their offerings. This Comment will discuss the various steps that can be taken to utilize the current state of this troubled law and explain its practical effects.[11] This Comment will also provide further information into real estate crowdfunding, one of the most promising types of crowdfunding since it is a hard-backed asset.[12] Furthermore, with the recent presidential election, there are several potential political changes that could occur within this legislation which should be considered by both business owners and potential investors.[13]

II. BRIEF HISTORY OF REGULATION WITHIN THE UNITED STATES

Throughout the history of U.S. investments, "the practice of investing has been kept among the wealthy, who could afford to buy into stocks and purchase debt in the form of bonds."[14] It was widely believed that the wealthy could handle the risk associated with investing, due to their "considerable wealth base" and ability to handle potential losses.[15] Furthermore, the high-level fraud that existed in the "early financials was enough to scare off most of the casual investors."[16]

Over time investing became increasingly popular, and "all classes of people" began to enjoy "finding new places to invest their money."[17] From 1911–1933, securities sales in the United States were regulated exclusively by special-

[11] *See infra* Part V.
[12] *See infra* Part VI.
[13] *See infra* Part VII.
[14] Andrew Beattie, *The SEC: A Brief History Of Regulation*, http://www.investopedia.com/articles/07/secbeginning.asp (last visited Feb. 17, 2017).
[15] *Id.*
[16] *Id.*
[17] *Id.*

ized state statutes, referred to as Blue Sky Laws; in theory, these "new investors" were supposedly protected by Blue Sky Laws.[18] Blue Sky Laws were intended to "protect investors from worthless securities."[19]

However, in reality Blue Sky Laws were "weak in both terms and enforcement."[20] Blue Sky Laws were monitored on a state level basis, and these laws varied from state to state.[21] Therefore, companies that wanted to "avoid full disclosures would simply offer shares by mailing them to out-of-state investors."[22] Since Blue Sky Laws varied from state to state, the validity of the disclosures were not "thoroughly checked by the state regulators."[23] During the 1920s, the economy was roaring and people were anxious to "get their hands on anything to do with the stock market."[24] With many uninformed investors investing into the market, the situation was ideal for manipulation.[25] Stockbrokers, owners, bankers, and market makers began trading stocks among "themselves to drive prices higher and higher before unloading shares on the ravenous public."[26]

This market manipulation eventually led to the Great Depression of 1929.[27] The stock market crash "sent Wall Street into a panic and wiped out millions of investors."[28] The losses from the stock market "ravaged both domestic and world finances."[29] As the fallout from the market crash settled, the U.S. government decided to take action in order to prevent anything like the Great Depression from happening again.[30]

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[18] Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 348, (1991–1992).

> Blue Sky Laws are "basic disclosure laws that require a company to provide a prospectus in which the promoters (sellers/issuers) state how much interest they are getting and why (the Blue Sky Laws are still in effect today). Then, the investor is left to decide whether to buy. Although this disclosure was helpful to investors, there were no laws to prevent issuers from selling a security with unfair terms as long as they 'informed' potential investors about it.

Id.

[19] *See* Beattie, *supra* note 14.

[20] *Id*. *See also* Forrest B. Ashby, *Federal Regulation of Securities Sales,* 22 ILL. L. REV. 635 (1928) (discussing proposals for a federal Blue Sky Law to remedy the enforcement of postal fraud laws).

[21] Mark J. Astarita, *Introduction to Blue Sky Laws,* SECLAW.COM, http://www.seclaw.com/bluesky.htm (last visited Mar. 31, 2017).

[22] *See* Beattie, *supra* note 14.

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] Great Depression, THE HISTORY CHANNEL, https://www.history.com/topics/great-depression (last visited Mar. 11, 2018).

[28] *Id.* "The stock market, centered at the New York Stock Exchange on Wall Street in New York City, was the scene of reckless speculation, where everyone from millionaire tycoons to cooks and janitors poured their savings into stocks. As a result, the stock market underwent rapid expansion, reaching its peak in August 1929." *Id.*

[29] *See* Beattie, *supra* note 14.

[30] *Id.*

In 1933, the Securities Act was passed through Congress.[31] The Securities Act was intended to create a stronger version of the state Blue Sky Laws at the federal level.[32] The Securities Exchange Act of 1934 created the Securities and Exchange Commission (SEC).[33] President Roosevelt believed that the initial "problem with the Blue Sky Laws was a lack of enforcement," and thus, "investor confidence had been shattered by the crash."[34] Legal control on the "issuing and trading of securities were virtually nonexistent, allowing for any number of frauds and other schemes."[35] The SEC was created to protect investors, prevent securities fraud, and assist in the creation of new capital for businesses and investments.[36]

The SEC has continued to make the market a safer place for investors and "continues to learn from and adapt to the scandals and crises that occur despite its best efforts."[37] "The biggest challenge for the SEC is to find the balance between protecting investors from bad investments by making sure that they have accurate information, and outright blocking investors from investing in areas that the SEC believes are bad."[38] Although the SEC has been an extremely important shield for protecting investors, there is fear that "both its power and love of tighter regulations will eventually harm the market."[39] This love and power over tighter regulations is the precise problem with Title III of the JOBS Act.[40] Until the Crowdfunding Act is reformed, the market, businesses, and investors will suffer.[41]

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[31] *Securities Act Of 1933*, INVESTOPEDIA, http://www.investopedia.com/terms/s/securitiesact1933.asp (last visited Feb. 18, 2017).

[32] *See* Beattie, *supra* note 14.

[33] *Id.*

> In contrast to the Securities Act of 1933, the Exchange Act primarily regulates transactions of securities in the secondary market—that is, sales that take place after a security is initially offered by a company (the issuer). These transactions often take place between parties other than the issuer, such as trades that retail investors execute through brokerage firms. The Exchange Act operates somewhat differently from the Securities Act. To protect investors, Congress crafted a mandatory disclosure process that is designed to force companies to make public information that investors would find pertinent to making investment decision. In addition, the Exchange Act provides for direct regulation of the markets on which securities are sold (the securities (stock) exchanges) and the participants in those markets (industry associations, brokers, and issuers).

Deepa Sarkar, *Securities Exchange Act of 1934*, LEGAL INFORMATION INSTITUTE https://www.law.cornell.edu/wex/securities_exchange_act_of_1934 (last visited June 2016).

[34] *See* Beattie, *supra* note 14.

[35] *Securities And Exchange Commission*, HISTORY.COM, http://www.history.com/topics/securities-and-exchange-commission (last visited Feb. 26, 2018).

[36] *Id. See also What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/whatwedo.shtml (June 10, 2013).

[37] *See* Beattie, *supra* note 14.

[38] *Id.*

[39] *Id.*

[40] *See generally infra* Part IV.

[41] *See generally infra* Part IV.

III. BACKGROUND LAW

According to federal securities law, a company or private fund may not offer or sell securities unless the transaction has been registered with the SEC or an exemption from registration is applicable.[42] Following the most recent economic recession, on April 5, 2012, former President Barrack Obama signed into law the JOBS Act,[43] which amended federal securities laws to increase availability of funding for businesses.[44] The JOBS Act increased small-business access to capital markets with the intention of spurring job creation and economic growth.[45] Within the JOBS Act, there were four exemptions to the Securities Act of 1933.[46] This Comment will discuss two of those exemptions: Title II and Title III (collectively, "crowdfunding").

A. *Title II*

Title II, which is also known as Access to Capital for Job Creators, became effective on September 23, 2013.[47] Title II allows general solicitation and advertising to accredited investors who are eligible to invest.[48] Prior to this exemption, general solicitation and advertising were prohibited.[49]

Notably, Title II applies *only to accredited investors*.[50] "The SEC sets the standards for accredited investors, which is sometimes seen as a judgment call on the part of the SEC, and perhaps, a shift from protecting investors from unsafe investments to 'protecting investors from themselves.'"[51] An accredited investor is defined as a natural person who earned an income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years and "reasonably expects the same for the current year," or has a net worth of over $1 million either alone or together with a spouse.[52] Only 7.4% of all households in America qualify

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[42] *Accredited Investors*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/investor/alerts/ib_accreditedinvestors.pdf (last visited Feb. 26, 2018). It is unlawful to sell securities unless a registration state is in effect as to those securities, unless there is an exemption. Securities Act of 1933 § 5(a)(1) (codified at 15 U.S.C. § 77e(a)(1) (2015)).

[43] Jumpstart Our Business Startups Act, Pub. L. No. 112–106, 126 Stat. 306 (2012) [hereinafter JOBS Act]; Lindeen v. SEC, 825 F.3d 646, 651 (D.C. Cir. 2016).

[44] JOBS Act §§ 301–305, 126 Stat. at 315–23. "CROWDFUND" is an acronym for "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure." *Id.* at § 301.

[45] *Lindeen*, 825 F.3d at 651.

[46] 15 U.S.C. § 77.

[47] *Id.*

[48] *Id.*

[49] Arina Shulga, *How to Verify That Your Investor is Accredited - The SEC Provides New Explanations Regarding Rule 506(c) Offerings*, BUS. L. POST (July 11, 2014, 11:12 AM), http://www.businesslawpost.com/2014/07/how-to-verify-that-your-investor-is.html.

[50] 15 U.S.C. § 77.

[51] *See* Beattie, *supra* note 14.

[52] *Accredited Investors*, *supra* note 42.

as an accredited investor under that standard.[53] For an investor to prove that they are indeed an accredited investor, they must provide written confirmation.[54] Written confirmation must be provided by a CPA, attorney, investment advisor, broker-dealer, or income-related IRS forms.[55]

One principal purpose of the accredited investor concept is to identify persons who can bear the economic risk of investing in unregistered securities.[56] There is no limit on the amount of money that can be raised under a Title II exemption, and there is no limit on the number of accredited investors who can invest.[57] Since Title II allows businesses to advertise and to solicit investments from accredited investors, about 90% of all JOBS Act investments are limited to accredited investors.[58]

Title II requires businesses seeking to advertise to file a Form D[59] with the SEC before beginning solicitation and to disclose details about the general solicitation within fifteen days of the first solicitation.[60] Furthermore, in order to advertise to accredited investors, reasonable steps must be taken to ensure that the

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53 ELIMINATING THE PROHIBITION AGAINST GENERAL SOLICITATION AND GENERAL ADVERTISING IN RULE 506 AND RULE 144A OFFERINGS, 17 C.F.R §§ 230, 239; *see also* Linn White, *Article: Title III of the Jobs Act: Congress Invites Investor Abuse and Leaves the SEC Holding the Bag*, 52 WILLIAMETTE L. REV. 227, 242 (2015).

54 *See* Shulga, *supra* note 49.

55 *Id.*

56 15 U.S.C. § 77.

57 *Id.*

58 Robert B. Robbins, *Practical Implications of the JOBS Act Changes to Private Placements: Rule 506(c), Crowdfunding, and Reg A+*, PILLSBURY (Oct. 6, 2014), http://www.pillsburylaw.com/siteFiles/Publications/WhitePaperOct2014CorporateandSecuritiesPracticalImplicationsoftheJOBSActChanges.pdf.

59 15 U.S.C. § 77; U.S. SEC. & EXCH. COMM'N, *Fast Answers: Form D* https://www.sec.gov/answers/formd.htm, (last modified Nov. 27, 2017) ("Form D is a brief notice that includes basic information about the company and the offering, such as the names and addresses of the company's executive officers, the size of the offering and the date of first sale.").

60 15 U.S.C § 77.

advertisement audience consists of accredited investors.[61] The penalty for not adequately meeting and following general solicitation requirements with the SEC is prohibition from fundraising for a full year.[62]

The effects of this law will greatly help businesses find capital and accredited investors find equity investments. Since "the general solicitation ban has been lifted, startups and small businesses will be able to leverage the internet as a marketing tool for their fundraising."[63] Businesses are now able to leverage marketing by using "online investment platforms where investors have already been engaging, like CircleUp or Crowdfunder, to reach potentially thousands of potential investors."[64] Prior to the crowdfunding exemption, "reaching a targeted audience of [twenty] or more active investors often took [four] to [six] months."[65]

B. Title III

Although Title III of the JOBS Act was passed in 2012,[66] this exemption did not take effect until May 16, 2016.[67] Title III of the JOBS Act created a new federal securities law exemption for crowdfunding securities offerings that allowed

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[61] Jor Law, *Everything You Need to Know About Accredited Investor Verification*, CROWDFUND INSIDER (Oct. 8, 2015), http://www.crowdfundinsider.com/2015/10/75509-everything-you-need-to-know-about-accredited-investor-verification/.

> The principles-based method allows the issuer to make a reasonable determination of accredited investor status by considering elements such as (i) the nature of the purchaser and the type of accredited investor that the purchaser claims to be; (ii) the amount and type of information that the issuer has about the purchaser; (iii) the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and (iv) the terms of the offering, such as a minimum investment amount. However, an issuer relying on the principles-based method bears the risk that their judgment wasn't reasonable. If it is determined at any single investor wasn't properly verified, then the issuer could lose the entire Rule 506(c) exemption for their offering with disastrous consequences. The non-exclusive safe harbor verification methods are recommended by many securities attorneys and preferred by many issuers as they provide certainty of legal compliance. The safe harbor methods generally fall into one of the following categories: (i) verification of a natural person's income by looking at US tax documentation, (ii) verification of a natural person's net worth by looking at a US credit report for liabilities and bank statements, brokerage statements, real estate appraisals, etc., for assets, and (iii) verification conducted by certain third-party licensed or registered professionals.

Id.

[62] 15 U.S.C § 77.

[63] Chance Barnett, *The Crowdfunder's Guide To General Solicitation And Title II Of The JOBS Act*, FORBES (Sept. 23, 2013), http://www.forbes.com/sites/chancebarnett/2013/09/23/the-crowdfunders-guide-to-general-solicitation-title-ii-of-the-jobs-act/2/#2c59e7cf5448.

[64] *Id.*

[65] *Id.*

[66] 15 U.S.C § 77.

[67] *Id.*

anyone—not just accredited investors—to invest.[68] Since multiple investors may invest in a startup using these offerings, these programs have come to be known as "crowdfunding."[69] Crowdfunding is defined as the practice by which a company raises capital through a large number of small individual investments.[70]

The idea behind crowdfunding is based on the "wisdom of the crowd."[71] The idea is that if "you can take the most sophisticated experts in any field and put it out to the consciousness of the world[,] a crowd of a thousand [non] experts will make better decisions."[72] Thus, if many people invest in an idea, it serves as a way to show that the business was likely a good investment.[73] There have been studies that show that the "wisdom of the crowd" is meritorious because of "the diverse opinion of each person's private information, their independence of those opinions, and the aggregation of the collective view."[74]

Due to the recession in 2008, banks and other institutions were not lending out capital like they had in previous years.[75] The main legislative goal of the JOBS Act is to promote confidence in the marketplace by protecting investors from fraud and deception while allowing businesses to raise capital.[76] By enabling startup companies to solicit funds from the general public, the congressional intent of crowdfunding was to provide entrepreneurs with a quick and inexpensive method of raising necessary early stage capital,[77] thereby reducing the disproportionately high costs that small companies face when going public.[78] Congress hoped that allowing business to generate capital from a wider range of investors would spur economic growth through job creation.[79] Accordingly, Congress created these exemptions to help businesses receive the capital that they need to thrive while allowing Americans to invest in new companies they believed in.[80]

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[68] *Id*. at §§ 301–05.

[69] Gust, Inc. v. AlphaCap Ventures, LLC, 226 F.Supp.3d 232 (S.D.N.Y. 2016).

[70] Gregory K. Bader, THE JOBS ACT: NEW RULES FOR RAISING MONEY AND GOING PUBLIC (2012).

[71] David Gustin, *The Wisdom of the Crowd Theory and Crowdfunding*, SPENDMATTERS (July 13, 2016 7:45 AM), http://spendmatters.com/tfmatters/wisdom-crowd-theory-crowdfunding/.

[72] *Id.*

[73] JAMES SUROWIECKI, THE WISDOM OF THE CROWDS: WHY THE MANY ARE SMARTER THAN THE FEW AND HOW COLLECTIVE WISDOM SHAPES BUSINESSES, ECONOMIES, SOCIETIES, AND NATIONS xiii–xiv (2004).

[74] *See* Gustin, *supra* note 71.

[75] Richard Finger, *Banks Are Not Lending Like They Should, And With Good Reason*, FORBES (May 30, 2013, 10:06 AM), http://www.forbes.com/sites/richardfinger/2013/05/30/banks-are-not-lending-like-they-should-and-with-good-reason/#54b561a744b1.

[76] Crowdfunding, S. 158, 112th Cong. § 5474 (2012).

[77] Thomas V. Powers, *SEC Regulation of Crowdfunding Intermediaries Under Title III of the JOBS Act*, 31 No. 10 BANKING & FIN. SERVICES POL'Y REP. 1, 1 (Oct. 2012).

[78] *Id.*

[79] Rebecca Lake, *Guide to Crowdfunded Investments for Non-Accredited Investors*, INVESTOPEDIA (May 2, 2016), http://www.investopedia.com/articles/entrepreneurship-small-business/050216/guide-crowdfunded-investments-nonaccredited-investors.asp.

[80] Press Release, SEC, SEC Adopts Rules to Permit Crowdfunding, Proposes Amendments to Existing Rules to Facilitate Intrastate and Regional Securities Offerings (Oct. 30, 2015).

The original backers of crowdfunding wanted a "nearly regulation free zone" where businesses in their early stages could "display their business plan and seek out small investors who could share their entrepreneurial dream, however risky it may be."[81] However, this exemption picked up significant restrictions and limitations along the way.[82] These restrictions have posed significant complications and problems to the exemption, a cost which businesses and investors ultimately have ended up bearing.[83]

Title III was the most anticipated piece of crowdfunding legislation to become effective.[84] For the first time, ordinary people that did not qualify as accredited investors were now able to invest in new businesses.[85] Prior to Title III, only accredited investors could invest in early stage businesses.[86] This new regulation increased the potential investor pool to over 300 million potential investors.[87] Although Title III enabled small companies to successfully raise capital at modest costs, Congress ensured that "investor protections" would be put in place.[88]

There are considerable limitations that are imposed on crowdfunding.[89] These limitations include raising a maximum of $1 million in a twelve month period from a maximum of thirty-five unaccredited investors, provided that no investor exceeds an individual investment cap based on the investor's annual income or net worth.[90] The SEC opted to place restrictions on how much an unaccredited investor can invest over a twelve-month period based on the individual's net worth and income.[91] For individuals who make less than $100,000 per year or who have a net worth below that amount, the greater of $2,000 or the lessor of 5% is eligible for investment.[92] For individuals who have a net worth that exceeds $100,000, up to 10% of their income or net worth can be invested, whichever is less, and these unaccredited investors are subject to a $100,000 investment limit.[93]

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[81] Robert Thompson & Donald Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573 (2013).

[82] *Id.*

[83] *See generally infra*, Part IV.

[84] Amy Wan, *Title III Crowdfunding Became Legal on May 16: What It Does & What's Still Lacking*, CROWDFUND INSIDER (May 17, 2016), https://www.crowdfundinsider.com/2016/05/85696-title-iii-crowdfunding-became-legal-on-may-16-what-it-does-whats-still-lacking/.

[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *See* Bader, *supra* note 70.

[89] 15 U.S.C. § 77(d).

[90] JOBS Act § 302(a), 126 Stat. 315. Specifically, investors with less than $100,000 in annual income or net worth can invest up to the greater of $2,000 or 5% of their annual income or net worth. Investors with more than $100,000 in annual income or net worth may invest up to 10% of their annual income or net worth, subject to a $100,000 maximum investment. *Id.*

[91] 15 U.S.C. § 77(d).

[92] *Id.*

[93] *Id.*

The purpose of this exemption is to limit the risk to unaccredited investors since they may "not be as knowledgeable about crowdfunding or investing in general."[94] By restricting how much money can be invested by unaccredited investors, the SEC is effectively limiting how much unaccredited investors can "lose if a particular investment falls flat."[95] Additionally, crowdfunding must be effectuated through crowdfunding intermediaries, such as registered brokers or "funding portals."[96] All intermediaries must apply to be a funding portal with the SEC.[97] These intermediaries are subject to limitations and must comply with a number of disclosure and due diligence requirements.[98]

Under Title III, startup company issuers must also disclose certain information to the SEC, crowdfunding intermediaries, and unaccredited investors.[99]

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[94] *See* Lake, *supra* note 79.

[95] *Id.*

[96] JOBS Act § 302(a), 126 Stat. 315. Funding portals are broker-like intermediaries created by the JOBS Act. Thomas V. Powers, *SEC Regulation of Crowdfunding Intermediaries Under Title III of the JOBS Act*, NUTTER, https://www.nutter.com/assets/htmldocuments/Banking-&-Financial-Services-Policy-Report-SEC-Regulation-of-Crowdfunding-%20Intermediaries-Under-Title-III-of-the-JOBS%20Act-October%202012.pdf (last visited Jan. 29, 2018); *see also* SEC v. Inteligentry, Ltd., No. 2:13-cv-00344-RFB-NJK, 2015 U.S. Dist. LEXIS 42868, at *35 (D. Nev. Mar. 31, 2015) (holding that crowdfunding exemption requires offerings to be transacted through a compliant broker or funding portal); *see also* Kickstarter, Inc. v. Artistshare, Inc., 2012 U.S. Dist. LEXIS 50444 (holding that there can be multiple funding portal sites, and these sites do not infringe on patent rights).

[97] JOBS Act §302(b), 126 Stat. 315–17.

[98] *Id.* "A funding portal must register with the SEC and be subject to the SEC's examination, enforcement and rulemaking authority. Furthermore, for companies that raise over $500,000, significant disclosures in the form of audited financials are required. This can create an annual cost of $10,000+ for years down the line." Alex, *Crowdfunding: Understanding Title II And Title III of the JOBS Act*, BEND LAW GROUP, PC (Jan. 1, 2016), http://www.bendlawoffice.com/2016/01/03/crowdfunding-and-the-important-distinctions-between-title-ii-and-title-iii-of-the-jobs-act/.

[99] JOBS Act § 302(b), 126 Stat. 317–18.

> Disclosures include, without limitation: 1. Name, legal status, address and website of the issuer; 2. Names of officers, directors and 20 percent holders of the issuer; 3. Business of the issuer and anticipated business plan; 4. Description of the financial condition of the issuer, with financial information and financial statements that vary based upon the target offering amount (combined with other offerings of the issuer under the exemption within the preceding 12 months); 5. Use of proceeds; 6. [T]he target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount (This formulation implies that every offering must have a target offering amount). 7. Price to the public or method for determining price, providing that prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities; 8. A description of the ownership and capital structure of the issuer, including (very generally and without limitation) the terms of the securities, description of how the exercise of rights held by principal shareholders of the issuer could negatively impact the investors, the name of 20 percent holders, valuation methods, and risks to purchasers of a minority investment in the issuer.

Samuel Wolff, *The JOBS Act: Part 2*, 34 No. 5 SEC. & FED. CORP. L. REP. 1 (2012) (internal quotation marks omitted).

Additionally, startups cannot advertise their offerings unless they are directed to accredited investors only.[100] This can become tricky because the consequences of advertising to unaccredited investors are not entirely known.

Although well intended, there are many significant issues with the current state of the crowdfunding laws and regulations of Title III. Due to the need for reform, the "Fix Crowdfunding Act" was introduced to the House of Representatives on March 23, 2016.[101]

C. The Fix Crowdfunding Act

The Fix Crowdfunding Act moves to suspend certain Title III requirements and amend the more practical provisions.[102] These provisions include enabling special purpose vehicles,[103] raising the dollar amount limit from \$1 million to \$5 million in a twelve-month period, and clarifying certain requirements and exclusions for funding portals.[104] These changes are described in depth and compared to the current Title III requirements below.

These proposed changes were passed by the House of Representatives and are now awaiting the review of the Senate.[105] However, there is a chance that this bill will not get passed by the Senate.[106] This Comment will discuss why it is crucial that the Fix Crowdfunding Act is passed and what businesses and investors should consider in the meantime.

IV. COMPARISON OF THE CURRENT CROWDFUNDING EXCLUSION TO THE PROPOSED FIX CROWDFUNDING ACT

The current legislation of Title III is detrimental to both investors and businesses.[107] It could hinder the success of crowdfunding in the future if businesses and investors have negative experiences, and thus could potentially take unaccredited investors back out of investment opportunities all together.[108] Unaccredited investors are not as attractive to businesses as accredited investors due to the restrictions of crowdfunding compared to Title II.[109] Therefore, it is unlikely that unaccredited investors will have the opportunity to invest in the most promising

[100] *See* Wolff, *supra* note 99.

[101] *See Fix Crowdfunding Act*, *supra* note 5.

[102] *Id.*

[103] *Id.* Special purpose vehicles would allow a group of investors to come together and pool their resources to invest alongside other more sophisticated investors. *Id.*

[104] *Id.*

[105] JD Alois, *The Fix Crowdfunding Act Passes House & Heads to the Senate*, CROWDFUND INSIDER (July 5, 2016), https://www.crowdfundinsider.com/2016/07/87565-fix-crowdfunding-act-passes-house-heads-senate/.

[106] *See Fix Crowdfunding Act*, *supra* note 5.

[107] *See generally infra* Part IV.

[108] *Id.*

[109] *Id.*

start-up businesses due to the existing laws.[110] Below, the practical effects and costs of the current crowdfunding laws to the proposed Fix Crowdfunding Act are discussed.

A. The Practical Effect of Title III on Businesses and Investors Alike

1. The $1 Million Limit and Strict Regulations Imposed on Unaccredited Investors

"The $1 million cap is intended to protect unaccredited investors from fraud or from simply making outright poor investment decisions."[111] However, this $1 million cap makes "crowdfunding expensive, complicated, inefficient, and risky for unsophisticated investors."[112]

The additional disclosures required by Title III for unaccredited investors to even have the chance to invest in a new company are significantly more expensive than Title II.[113] The JOBS Act requires disclosures such as obtaining independent audits, disclosure documents, filing fees, and legal fees which can cost a new business up to $150,000.[114] That cost has to be taken up front, before a business can even sell its equity through crowdfunding.[115] This is a remarkably high cost for a new business to incur to simply try crowdfunding.[116] "The required disclosure and ongoing reporting requirements, combined with the need to compensate attorneys, intermediaries and others, will likely make JOBS Act crowdfunding unreasonably burdensome for offerings that cannot exceed $1 million."[117] Furthermore, it is a cost that can be avoided entirely simply by subjecting unaccredited investors to the same regulations as accredited investors.[118]

Title II exemptions, for example, which only include accredited investors in investments, can be up to *six times* cheaper than Title III exemptions.[119] This is due largely to the fact that the JOBS Act does not require those additional up front

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[110] *Id.*

[111] Seth C. Oranburg, *Bridgefunding: Crowdfunding and the Market for Entrepreneurial Finance*, 25 CORNELL J.L. & PUB. POL'Y 397 (2015).

[112] *Id.*

[113] *Id.*

[114] Sherwood Neiss, *It Might Cost You $39k to Crowdfund $100k Under the SEC's New Rules*, VENTUREBEAT, (Jan. 2, 2014), http://venturebeat.com/2014/01/02/it-might-cost-you-39k-to-crowdfund-100k-under-the-secs-new-rules/ (explaining a cost-benefit report that looked at success fees, compliance costs, and costs of CPA to review or audit).

[115] *See* Oranburg, *supra* note 111, at 401.

[116] *Id.*

[117] *See* Robbins, *supra* note 58.

[118] *See generally supra* Part III.

[119] *See* Oranburg, *supra* note 111, at 401.

audits and fees for accredited investors.[120] Furthermore, Title II investment regulatory costs are mostly incurred after financing is assured, whereas Title III has to sink their costs up front in order to give crowdfunding a try.[121]

Due to these high starting costs under Title III, many businesses that are deemed to be potentially successful from the accredited investor "crowd" will likely not bother with unaccredited investors.[122] Unaccredited investors are not capable of investing nearly as much as accredited investors due to Title III restrictions, considering that they can only raise up to $1 million in a twelve-month period and are subject to more regulations and disclosures.[123] Title II has no monetary cap on how much money can be raised, and accredited investors are not subject to the heavy, expensive disclosures that are required by current crowdfunding laws of Title III.[124] Therefore, using Title III versus Title II is significantly more costly and regulated, which will slow a new business down from getting started and providing returns for its investors.

With the proposed Fix Crowdfunding Act, these regulatory costs would be more easily absorbed since unaccredited investors would be able to raise up to $5 million in a twelve-month period.[125] The problem with the current limitations is "in essence, you are subjecting very low fundraising to very expensive regulatory disclosures" which is a problem because it is "economically costly and restricts economic opportunity."[126] Even if Title III still requires those additional restrictions and regulations, businesses will be more likely to allow unaccredited investors to invest, since a maximum investment of $5 million is likely worth their time, compliance with regulations, and upfront costs.[127] Furthermore, it would not subject unaccredited investors to any further risk, since the same limitations would still be imposed on how much they could invest.[128] This change to the legislation would simply allow unaccredited investors to be a more attractive funding option for businesses and would allow them the ability to participate in more investments if they choose to do so.[129]

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[120] *Id.*

[121] *Id.*

[122] *See generally supra* Part IV.

[123] 15 U.S.C. § 77d; JOBS Act §§ 301–05, 126 Stat. at 315–23.

[124] Title II JOBS Act.

[125] *See Fix Crowdfunding Act, supra* note 5. Additionally, this raise in capital is crucial for unaccredited investors to have the opportunity to invest in special purpose vehicles. "Seán Sebastian, a partner at Birchmere, explains that his SPVs typically fall between 3 and 8 million in size. Despite the fact that SPVs only offer exposure to a single investment, they can provide the same 20 percent carry at the time of exit." John Mannes, *An Oasis in the Desert: Special Purpose Vehicles and Behavioral Economics*, TECHCRUNCH (Apr. 1, 2016), https://techcrunch.com/2016/04/01/an-oasis-in-the-desert-special-purpose-vehicles-and-behavioral-economics/.

[126] *See Fix Crowdfunding Act*, *supra* note 5, at 4237.

[127] *See generally supra* Part IV.

[128] *See Fix Crowdfunding Act*, *supra* note 5.

[129] *Id.*

2. *Special Purpose Vehicles*

The harsh truth of investing in new businesses is that many new businesses will fail.[130] Approximately 66% of all new businesses will fail within the first ten years.[131] Given these statistics and the fact that accredited investors are considered to be more sophisticated and have also been able to invest in these new businesses significantly longer than unaccredited investors, it makes sense that unaccredited investors want to follow what accredited investors are doing and use their investment patterns as the "wisdom of the crowd."[132]

However, the issue is that many of these more promising investments will likely be bought by accredited investors, and due to the large costs of regulations and liability of having unaccredited investors, these businesses will be more likely to stick with Title II, rather than bothering with Title III.[133] Therefore, unaccredited investors will end up being left out of promising investments due to the way that the legislature is currently structured. The same regulations that are aimed to protect unaccredited investors are actually hindering their ability to invest in companies that have a higher likelihood of success.[134] Furthermore, from a public policy perspective, unaccredited investors do not have nearly as much money as accredited investors,[135] and they should have an equal opportunity to access the best investments that are most likely to yield return money on their investments. The current SEC laws are holding unaccredited investors back.[136]

The proposed Fix Crowdfunding Act would implement "special purpose vehicles," which would be used to put unaccredited investors' funds together to invest with a more sophisticated investor.[137] A special purpose vehicle "is a legal entity created for a specific purpose."[138] In the context of raising capital, a special

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[130] Gretchen Schmid, *17 Statistics Every Business Owner Needs to Be Well Aware Of*, FUNDERA, https://www.fundera.com/blog/small-business-statistics (last visited July 19, 2017).

[131] *Id.*

[132] *See Fix Crowdfunding Act*, *supra* note 5.

[133] *See generally supra* Part IV.

[134] *Id.*

[135] 15 U.S.C. § 77b.

[136] *See Fix Crowdfunding Act*, *supra* note 5.

[137] *Id.*

[138] AnMaree Williams, *Special Purpose Vehicle (SPV)*, SEEDINVEST TECH. (Oct. 27, 2016), https://www.seedinvest.com/academy/a-special-purpose-vehicle.

> Typically, financial institutions, banks, and business owners use special purpose vehicles to improve finance management and make businesses more tax efficient. *Id.* "However, there are tax implications that go with having an SPV. First of all, the SPV will have to pay corporate tax on its profits and although there are no taxes charged on special dividends of the SPV, if the dividends are received by a person, then that person will have to pay documentary tax and Capital Gains taxes of up to 25%, maybe more depending on the country. On the other hand, SPVs make it possible for creative handling manipulation of financial statements and the windows of opportunity for companies to choose a more favorable tax residence for their SPV where their assets are better secured.

Understanding the Complexities of the Special Purpose Vehicle, BLOSSOM WEALTH purpose vehicle "can be used as a funding structure, by which all investors (or investors under a given investment threshold) are pooled together into a single entity."[139] When utilized properly, special purpose vehicles can produce sizeable returns to investors.[140] The special purpose vehicle will be supervised by the special purpose vehicle manager.[141] Special purpose vehicles are limited to the objectives for which they were created,[142] which helps prevent potential opportunities for fraud. Furthermore, once the goal of the special purpose vehicle has been attained, the special purpose vehicle will be terminated.[143]

A special purpose vehicle can be a great investment opportunity for investors to make money if executed correctly.[144] Despite the fact that special purpose vehicles "only offer exposure to a single investment, they can provide the same 20 percent carry at the time of exit."[145] Typically, special purpose vehicles fall between \$3 to \$8 million in investment size.[146] This is another reason why it is crucial for The Fix Crowdfunding Act to raise the dollar limit to \$5 million on Title III investments for unaccredited investors.[147]

Opponents to this amendment fear that unaccredited investors could be tricked or fooled into so-called opportunities that are really not opportunities at all.[148] However, special purpose vehicles would help protect unaccredited investors from fraud because they would have a sophisticated investor to help them discern better investments.[149] Thus, special purpose vehicles would allow "unsophisticated people to get sophisticated advice."[150] Additionally, a registered investment advisor with a fiduciary duty to the fund would direct the investment.[151] This would allow the unaccredited investors the same rights to sue the company as if they had directly invested in the company itself.[152]

MANAGEMENT (Apr. 3, 2015), http://www.blossomwm.com/understanding-the-complexities-of-the-special-purpose-vehicle/.

[139] *See* Williams, *supra* note 138. Before the special purpose vehicle "is finalized . . . , the organization should be agreed upon. This includes establishing the legal structure that could be a trust, company, mutual fund, firm, or Statutory Corporation." *Id.* Note that most special purpose vehicles are created as an LLC entity. *See id*; 15 U.S.C. § 77b.

[140] Winter Mead, *To SPV or not to SPV: Decoding the Pros and Cons of Special Purpose Vehicles*, CB INSIGHTS (Aug. 10, 2015), https://www.cbinsights.com/blog/special-purpose-vehicles-in-venture-pros-and-cons/.

[141] *See* Williams, *supra* note 138.

[142] *See* Alex, *supra* note 98.

[143] *Id.*

[144] *See* Mead, *supra* note 140.

[145] *See* Mannes, *supra* note 125.

[146] *Id.*

[147] *See supra* Part IV.

[148] *See* Fix Crowdfunding Act, *supra* at note 5.

[149] *Id.*

[150] *Id.*

[151] *Id.*

[152] *Id.*

With the proposed changes of the Fix Crowdfunding Act, crowdfunding would be much more effective for both investors and businesses.[153] It is crucial that amendments are made to the current crowdfunding laws in order to further the intended goals of the legislature.[154] By fixing the monetary cap and implementing special purpose vehicles, Congress will be able to provide more economic opportunity and expand the utility of crowdfunding.[155] The Fix Crowdfunding Act would allow unaccredited investors to be exposed to the best investment opportunities, and in turn help them make better investments with their limited amount of money.[156]

V. WHAT THE CURRENT CROWDFUNDING LAWS MEAN FOR BUSINESSES AND INVESTORS

Currently, the JOBS Act exemption of crowdfunding is an unfulfilled promise.[157] Congress intended crowdfunding to open up investments to everyone.[158] While everyone can participate in crowdfunding, the rules do not apply the same to accredited investors under Title II. Until these laws are reformed and amended, there are certain considerations that should be made to protect investors and business owners. There has been an insufficient amount of time to determine how the JOBS Act will play out in our court systems, but there are some considerations that investors and business owners should take note of in the meantime.

A. How to Protect Yourself as a Business Owner

It is important for business owners to strictly follow JOBS Act regulations.[159] Although there have not been many cases on this issue yet since these exemptions are so novel, it is better to be safe than sorry. It would be in the best interest of a business owner to strictly use Title II until Title III has been amended.[160] The bottom line is that even though Title III allows for universal participation, not all new businesses are likely to jump on board due to various restrictions that the SEC has placed on unaccredited investors.[161] Business owners will still be able to raise capital through Title II and will not have to pay for the costly fees that come along with unaccredited investors. Title II permits advertisement and general so-

[153] *See generally supra* Part IV.
[154] *See generally supra* Part III(B).
[155] *See* Fix Crowdfunding Act, *supra* at note 5.
[156] *See generally supra* Part IV.
[157] C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, SEC. REG. L.J. 3 (2012).
[158] 15 U.S.C. § 78a.
[159] *Id.*
[160] *See generally supra* Part IV.
[161] Lake, *supra* note 79.

licitation to accredited investors, thereby allowing more potential accredited investors to be aware of business opportunities to invest in.[162] Furthermore, since general solicitation and advertising may be directed only to accredited investors under Title II, and Title II only permits accredited investors to participate in investments, there can be no claims of investors who invest and later claim to be unaccredited.[163]

"Even before the JOBS Act eliminated the prohibition against general advertising, Rule 506 offerings limited to accredited investors were very popular."[164] Data shows that the "vast majority" of equity investment offerings "were limited to accredited investors."[165] Title II seems to be the preferred and most popular method by a substantial amount.[166] Therefore, as a business owner it would be best to only offer equity investments under Title II.

B. How to Protect Yourself as an Investor

There are "no guarantees that any of these new businesses will succeed, and if the company fails, the equity shares could be worthless."[167] In reality, there is a 66% chance of failure for all new businesses within ten years.[168] If the business is successful, it could take years before investors are able to sell their shares.[169] The average time it takes a company to go public is about 8.25 years.[170] Therefore, illiquidity issues should be considered before investing in a new company.[171]

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[162] *See supra* Part III(A).

[163] *Id.*

[164] Rutheford B. Campbell Jr., *The New Regulation of Small Business Capital Formation: The Impact--If Any--Of the JOBS Act*, 102 KY. L.J. 815, 826 (2014).

[165] *Id.*

> Empirical data show, for example, that over a recent 25-month period there were 27,234 Regulation D offerings, and that 25,591 of those offerings (94%) were made under Rule 506. Based on a smaller sample of 1000 Regulation D filings, empirical data also show that the vast majority of all Regulation D offerings, including Rule 506 offerings, were limited to accredited investors. Within that smaller sample, 88.5% of all Regulation D offerings were limited to accredited investors, and 91.2% of all Rule 506 offerings were limited to accredited investors.

Rutheford B Campbell, Jr., *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 66 BUS. LAW 919, 926–29 (2011).

[166] *See* Robbins, *supra* note 58.

[167] Lake, *supra* note 79.

[168] Schmid, *supra* note 130.

[169] Lake, *supra* note 79.

[170] *Id.*

[171] Nav Athwal, *A Beginner's Guide to Real Estate Crowdfunding*, LANDLORDOGLOGY, (Dec. 24, 2016), https://www.landlordology.com/real-estate-crowdfunding/.

However, these types of investments are high risk, high reward.[172] Congress believed that people would use a "do your homework" standard, so before investing it is important to ensure that this is an investment that is worth the risk.[173] Investment fraud is common, and extensive research should be done to ensure that the investment is what it proclaims to be.[174] It is important to ask questions and ensure that the investment is not "too good to be true."[175] "Every investment carries some degree of risk, which is reflected in the rate of return you can expect to receive."[176] The SEC notes that "[i]f your money is perfectly safe, you'll most likely get a low return."[177] It would be most advantageous for crowdfunding investors to find opportunities that are hard backed assets, such as real estate.

VI. REAL ESTATE CROWDFUNDING

Real estate has a long history of profitability.[178] It is maintained by several experts that real estate is a preferred vehicle of the wealthy.[179] Roughly 90% of millionaires created their wealth through real estate.[180] "Investors used U.S. real estate crowdfunding platforms to pour $484 million into real estate projects" in 2015.[181] That is more than three times the amount that was used in 2014.[182] Crowdfunding has been particularly well received in the real estate sector.[183] This is likely because investors prefer "asset-based securities in general and real property in particular."[184] Real estate investing is a strategic way to diversify your portfolio while creating a secondary income stream.[185]

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[172] Lou Carlozo, *Crowdfunding: A New Frontier For Investors*, US NEWS & WORLD REPORT, (May 6, 2015), http://money.usnews.com/money/personal-finance/mutual-funds/articles/2015/05/06/crowdfunding-a-new-frontier-for-investors (last visited Feb. 17, 2017).

[173] *Id.*

[174] *What You Can Do To Avoid Investment Fraud*, INVESTOR.GOV https://www.investor.gov/protect-your-investments/fraud/how-avoid-fraud/what-you-can-do-avoid-investment-fraud (last visited Feb. 17, 2017).

[175] *Id.*

[176] *Id.*

[177] *Id.*

[178] Johnathon Yates, *90% Of The World's Millionaires Do This To Create Wealth,* THE COLLEGE INVESTOR (Dec. 27, 2017), https://thecollegeinvestor.com/11300/90-percent-worlds-millionaires-do-this/.

[179] *Id.*

[180] *Id.*

[181] Patrick Clark, *Inside the Real Estate Crowdfunding Land Rush: There are more than 125 places for investors to lose their shirts in real estate crowdfunding*, BLOOMBERG (May 10, 2016), https://www.bloomberg.com/professional/blog/inside-the-real-estate-crowdfunding-land-rush/.

[182] *Id.*

[183] Nav Athwal, *How Crowdfunding Has Changed Real Estate Investing*, FORBES (Dec. 2, 2015 11:53, AM), http://www.forbes.com/sites/navathwal/2015/12/02/how-crowdfunding-has-changed-real-estate-investing/#6ef5976418d8.

[184] Clark, *supra* note 181.

[185] Athwal, *supra* note 171.

"Real estate crowdfunding involves the pooling of funds by multiple investors into a real estate project."[186] Historically, participating in real estate investing was all about "who you knew."[187] However, the recent implementations of crowdfunding are changing that.[188] Crowdfunding is "rapidly reshaping" the way that investors find and invest into properties.[189] This shift has brought benefits for investors and businesses alike.[190] Now, "investors can access deals from the convenience of their laptop or tablet."[191] Crowdfunding will allow small real estate businesses the ability to fund their projects, despite their limited means to traditional capital.[192] However, this rapid growth also means important considerations for investors.[193]

A. *Types of Real Estate Investments Through Crowdfunding*

There are two main types of real estate investments to choose from: equity investments and debt investments.[194] Equity investments are investments in which "the investor is a shareholder in a specific property, and their stake is proportionate to the amount that they have invested."[195] Investors will receive returns "in the form of a share of the rental income the property generates, less any service fees paid to the crowdfunding platform."[196] Debt investments are investments in a mortgage loan associated with a particular property.[197] "The loan is secured by the property itself and investors receive a fixed rate of return that's determined by the interest rate on the loan and how much they have invested."[198]

Between the two investment types, "equity investments offer the potential for the bigger returns because profitability of debt investments is limited by the loan's interest rate."[199] However, equity investments are higher risk than debt investments, and they typically have a longer holding period.[200] Longer holding periods can lead to illiquidity problems. "Both equity and debt investments have their

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[186] *Id.*
[187] *Id.*
[188] *Id.*
[189] *Id.*
[190] *Id.*
[191] *Id.*
[192] Clark, *supra* note 181.
[193] *Id.*
[194] Athwal, *supra* note 171.
[195] Rebecca Lake, *Equity v. Debt Investments for Real Estate Crowdfunding*, INVESTOPEDIA, (Dec. 23, 2015), https://www.investopedia.com/articles/investing/122315/equity-vs-debt-investments-real-estate-crowdfunding.asp.
[196] *Id.*
[197] *Id.*
[198] *Id.*
[199] Athwal, *supra* note 171.
[200] *Id.*

good side and their bad side, which savvy investors take the time to weigh carefully."[201]

"Real estate crowdfunding platforms can vary widely in terms of how investments are structured[,] and that affects what an investor owns."[202] These structures are important because they will determine the shares owned through the investment and the tax benefits that can be associated with pass-through entities.[203] Debt investments will enable investors to have ownership of the note itself.[204]

B. Advantages of Using Crowdfunding for Real Estate Investments

Participating in real estate investments through crowdfunding offers certain advantages.[205] These advantages include investor accessibility, portfolio diversification, and tax benefits that are superior to investing in a real estate investment trust (REIT)[206] or purchasing a rental property.[207] Real estate crowdfunding is also advantageous for business owners due to the fact that online platforms "have lower overhead costs compared to banks, which can translate to fewer fees and lower interest rates for borrowers."[208] Furthermore, "real estate crowdfunding platforms have the ability to be more flexible in terms of the types of properties they are able to list to investors and the kinds of financing they offer."[209] Overall, "[c]rowdfunding is an attractive option for investors who want to invest in private real estate deals in a cost effective way."[210]

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[201] Lake, *supra* note 195.
[202] Athwal, *supra* note 171.
[203] *Id.*
[204] Lake, *supra* note 195.
[205] Athwal, *supra* note 171.
[206]
> A REIT is a company that owns, operates or finances income-producing real estate. Modeled after mutual funds REITs provide all investors the chance to own valuable real estate, present the opportunity to access dividend-based income and total returns, and help communities grow, thrive and revitalize. REITs allow anyone to invest in portfolios of real estate assets the same way they invest in other industries—through the purchase of individual company stock or through a mutual fund or exchange traded fund (ETF). The stockholders of a REIT earn a share of the income produced through real estate investment—without actually having to go out and buy, manage or finance property. Most REITs operate along a straightforward and easily understandable business model: By leasing space and collecting rent on its real estate, the company generates income which is then paid out to shareholders in the form of dividends. REITs must pay out at least 90 percent of their taxable income to shareholders—and most pay out 100 percent.

What's a REIT?, NAREIT, https://www.reit.com/what-reit (last visited Mar. 14, 2018).
[207] *See* Athwal, *supra* note 171.
[208] *Id.*
[209] *Id.*
[210] Lake, *supra* note 195.

1. *Investor Accessibility*

Real Estate crowdfunding will allow increased opportunity for more investors, since the buy-in cost is significantly less.[211] Some crowdfunding platforms allow a minimum investment of $1,000.[212] Theoretically, this allows accredited and non-accredited investors the ability to gain entry into real estate investments.[213] However, the more promising real estate developments are still mainly limited to accredited investors.[214]

2. *Portfolio Diversification*

Real estate crowdfunding platforms also make it easier to diversify real estate portfolios.[215] There are several options to diversify, such as debt and equity investments,[216] commercial and residential properties, and real estate funds that allow investors to gain exposures to several different sectors of the real estate market.[217]

3. *Tax Benefits*

Using crowdfunding for real estate investments "allows investors to benefit from certain tax breaks, such as depreciation."[218] Normally, these tax breaks only apply when the investor owns the investment property.[219] Furthermore, investors that invest in real estate equity will experience further tax benefits if their equity investment is accomplished through a pass-through entity.[220]

C. *Additional Considerations in Deciding Whether to Invest in Real Estate Crowdfunding*

There are over 125 real estate crowdfunding platforms to choose from,[221] and it is important to carefully choose in which platform one will ultimately invest.

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[211] Nicholas Leap, *You Can Now Invest In Real Estate, Even If You're Not Donald Trump*, CNN TECH (June 12, 2015, 12:15 PM), http://money.cnn.com/2015/06/12/technology/crowdfunded-commercial-real-estate/.

[212] *See* Athwal, *supra* note 171.

[213] *Id.*

[214] *See* Carlozo, *supra* note 172.

[215] *Id.*

[216] *See supra* Part IV(A).

[217] *See* Athwal, *supra* note 171.

[218] *Id.*

[219] *Id.*

[220] *Id.*

[221] Clark, *supra* note 181.

Furthermore, it is imperative for investors to review these investments themselves.[222] While many platforms obtain extensive research on investments before offering them to investors, some do not.[223] "Talking over the details of a specific deal with a financial advisor or fiduciary can help pinpoint potential issues."[224]

Investors should also factor in illiquidity, as real estate crowdfunding investments have very different liquidity schedules as well as unique return profiles for each independent investment.[225] It is crucial for investors to understand how long they will be locked into a deal when making their investment decisions.[226] Additionally, investors should consider potential changes in SEC legislation due to transitions of political power during the timeframe of their investments.

VII. TRUMP ADMINISTRATION CONSIDERATIONS

There has been discussion of the proposed changes that the Trump Administration will implement. In regard to the SEC, the JOBS Act, and Title II and Title III, several predictions have been made. "There is a lot of discussion about how the new Administration may weaken or even reverse many of the reforms that the commission and our fellow financial regulators have implemented since the financial crisis."[227]

After eight years of former enforcement regulators and criminal prosecutors leading the SEC, we can expect to see some changes in the agency under the Trump Administration.[228] Trump has nominated Wall Street lawyer Jay Clayton (Clayton) to be the head of the SEC.[229] Clayton has had no prior experience working for the government.[230]

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[222] Barbara Friedberg, *Which Is Best: REITs or Real Estate Crowdfunding?*, U.S. NEWS, (Apr. 25, 2018), https://money.usnews.com/investing/real-estate-investments/articles/2018-04-25/which-is-best-reits-or-real-estate-crowdfunding. "The best investors for REITs and real estate crowdfunding might not be the same . . . although real estate crowdfunding is less work than direct investment in properties, it still involves more due diligence than REIT investing." *Id.*

[223] Athwal, *supra* note 171.

[224] *Id.*

[225] *Id.*

[226] *Id.*; *see also* Friedberg, *supra* note 222 (explaining "REITS are extremely liquid and are traded daily across the financial markets, while the crowdfunding investing option makes a quick sale unlikely. So, the ease of REIT investing is trumped by the customization opportunities in real estate crowdfunding.")

[227] Renae Merle, SEC Chair White Concerned About Trump Administration's Plans To Roll Back Financial Reform, THE WASHINGTON POST (Jan. 17, 2017), https://www.washingtonpost.com/news/wonk/wp/2017/01/17/sec-chair-white-concerned-about-trump-administrations-plans-to-roll-back-financial-reform/?utm_term=.09aae5f65943.

[228] Brian Miller, *How will the SEC change under Trump's picks to lead it?*, THE HILL (Jan. 09, 2017, 1:20 PM), http://thehill.com/blogs/pundits-blog/finance/313325-how-will-the-sec-change-under-trumps-picks-to-lead-it.

[229] Merle, *supra* note 227.

[230] *See* Miller, *supra* note 228.

There are also two additional openings to fill on the five-member SEC Commission.[231] These SEC openings will enable the President to make a "sweeping transformation" of SEC regulations.[232] Discussed below are the pros, cons, and the overall effect that the Trump Administration may have on the JOBS Act exemptions.

A. *Pros*

President Trump stated "[w]e need to undo many regulations which have stifled investment in American businesses, and restore oversight of the financial industry in a way that does not harm American workers."[233] It is evident that the "Trump [A]dministration, and the SEC specifically, will attempt to undo portions of the oversight adopted after the 2008 financial crisis and recession."[234] It should not come as a surprise that Trump wants less regulation.[235] Of course, too much de-regulation risks fraud, so it is important that the right balance be implemented.[236] Additionally, "business regulation tends to burden smaller companies more than large ones as a percentage of revenue, so less is good."[237]

The SEC has been accused of both "gutting regulation" and "suffocating the market with too much of it."[238] "Once the agency is up to its full complement, we will likely see even more changes in policy. Those changes certainly will not be tilted toward increased regulation."[239] Some of the more controversial SEC regulatory rules that were developed in the 2008 financial crisis have not yet advanced, and now these proposals are "probably now regulated to the dustbin."[240]

The Trump Administration also wants to substantially lower taxes.[241] President Trump wants to lower taxes for both corporations and individuals.[242] This will help make more capital available for investments and personnel.[243] "Some believe that the super-rich do not need another tax cut. However, entrepreneurial companies could sure use some help."[244] Lowering taxes will enable investors to

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[231] Merle, *supra* note 227.
[232] *Id.*
[233] Miller, *supra* note 228.
[234] *Id.*
[235] *See* David N. Feldman, Here's how the Trump administration could affect entrepreneurship, SMARTCEO, http://www.smartceo.com/feldman-heres-how-the-trump-administration-could-affect-entrepreneurship/
(last visited Mar. 14, 2018).
[236] *Id.*
[237] *Id.*
[238] Merle, *supra* note 227.
[239] *See* Miller, *supra* note 228.
[240] *Id.*
[241] *See* Feldman, *supra* note 235.
[242] *Id.*; *see also* Lee Sheppard, *Trump's Tax Plan*, FORBES (Nov. 13, 2016), http://www.forbes.com/sites/leesheppard/2016/11/13/trumps-tax-plan/#f1baef411105.
[243] *See* Feldman, *supra* note 235.
[244] *Id.*

invest more money into new companies if they choose to do so and will also allow businesses to reinvest their saved tax dollars back into their business.

It can also be expected that the SEC will focus more on capital formation and facilitation of public offerings.[245] President Trump is prepared to spend significant amounts of money on infrastructure which will give a ton of small companies the opportunity to participate.[246] Further, President Trump is aware how crucial small businesses are to the economy and that small businesses create about 70% of all new jobs.[247] President Trump is willing to do all that he can to "rev up the job engine."[248]

It is also encouraging that Clayton, the proposed new SEC chairman, has a strong corporate finance background and a thorough understanding of the markets.[249] Clayton also has an understanding of complex financial instruments and their impacts on the market due to his "extensive experience representing large financial institutions."[250] Under the Obama Administration, appointees were focused more on enforcement initiatives than on capital formation.[251] Although that may have been due to the financial crisis environment that they were placed in, it is clear that there will be a shift in the SEC's focus now.[252]

If we face another large corporate scandal or financial crisis, the agency will quickly pivot back towards more regulation and oversight.[253] Enforcement at the SEC might be one of the few areas that will not change much under the Trump Administration.[254] Both Republicans and Democrats have sounded anti-Wall Street, anti-elite themes, and have pushed for even stronger enforcement.[255]

Regardless of which political party is in charge, the SEC will continue to investigate and prosecute fraud cases.[256] The professional enforcement staff of the SEC is largely self-executing.[257] When the staff presents new cases to the SEC for

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[245] Miller, *supra* note 228.
[246] Feldman, *see supra* note 235.
[247] *Id.*
[248] *Id.*
[249] *See* Miller, *supra* note 228.
[250] *Id.*
[251] *Id.*; *see also* William McLucas & Harry Weiss, *A New Administration: Change and Continuity in Securities Regulation*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Dec. 19, 2016), https://corpgov.law.harvard.edu/2016/12/19/a-new-administration-change-and-continuity-in-securities-regulation/.
[252] *Id.*
[253] *Id.*
[254] Andrew Ackerman & Michael C. Bender, *SEC Widely Expected to Ease Postcrisis Rules During Donald Trump's Administration*, THE WALL STREET JOURNAL, http://www.wsj.com/articles/sec-widelyexpected-to-ease-postcrisis-rules-during-donald-trumps-administration-1478717364 (last updated Nov. 9, 2016, 6:00 PM).
[255] *Id.*
[256] *See* Miller, *supra* note 228.
[257] *Id.*

approval, "even the staunchest Republican members of the commission have routinely authorized them."[258]

B. Cons

Mary Jo White (White), who is the outgoing head of the SEC, warns "of the dangers of the SEC losing its independence."[259] For example, the House has adopted legislation that requires regulators such as the SEC to more rigorously assess how much their rules cost the financial industry.[260] White fears that this measure would "impose conflicting, burdensome, and needlessly detailed requirements . . . that would provide no benefit to investors."[261]

> Furthermore, it should be questioned whether it is the best public policy to enact hundreds of pages of legislation imposing regulations under one administration, and then when power changes hands, enact hundreds of pages of legislation to undo those regulations, and then when power changes hands again, presumably enact hundreds of pages more to re-enact the regulations, and so on.[262]

To say the least, each election will impair businesses' ability to plan adequately for the future.[263]

International businesses should also be considered. International businesses will likely be affected with what Trump seeks to achieve.[264] It may cost more to bring raw materials into America, with potential tariffs and penalties.[265] Furthermore, NAFTA could be endangered.[266] However, exporting may become more attractive if other countries are incentivized to do so.[267]

Illegal immigration considerations could also pose a problem to businesses. Many small businesses, for good or for bad, hire undocumented immigrants for below the minimum wage.[268] This will likely become tougher to maintain under

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[258] *Id.*
[259] Merle, *supra* note 227.
[260] *Id.*
[261] *Id.*
[262] *See* Miller, *supra* note 228.
[263] *Id.*
[264] *See* Feldman, *supra* note 235.
[265] *Id.*
[266] *Id.*
[267] *Id.*
[268] *Id.; see also Illegal Immigration, Minimum Wage Law, and Morality*, VALUES CAPITALISM http://www.valuesandcapitalism.com/illegal-immigration-minimum-wage-law-and-morality/ (last visited Mar. 14, 2018).

the Trump Administration.[269] President Trump is against illegal immigrant workers for concerns that some of these jobs could go to unemployed citizens at minimum wage, his new trade deals will reduce pressure to go below the minimum wage, and if everyone follows the rules, there will be equal competition.[270]

C. Overall Effect

In sum, the Trump Administration is destined to shift its focus toward less regulation and more on capital formation.[271] While projected rules for the SEC are predictable over the next four years, things could change by the next election of 2020.[272] It is important to note that the average time it takes to liquidate an equity investment is 8.25 years.[273] Business owners and investors therefore should plan with this in mind and make their equity investment decisions accordingly.

President Trump is a business owner himself, and therefore will likely be pro-business.[274] The Trump Administration will push for less regulation, which will be beneficial to crowdfunding and will help unaccredited investors obtain better investing opportunities.[275] However, it will be important to balance the concept of less regulation with fraud protections.[276]

Since the Trump Administration plans on lowering taxes for investors and businesses, there will be more access to capital which will help the JOBS Act achieve its purpose and allow for a better economy.[277] President Trump also understands that small businesses account for 70% of American jobs, and he wants to help increase job opportunities.[278] The extent of these changes will largely depend on how much Congress repeals or revises the existing regulatory framework.[279]

Although there are many potential concerns with the change of power to the Trump Administration, the overall effect of the Trump Administration on Title II and Title III should be positive. An administration that emphasizes less regulation will allow unaccredited investors better investment opportunities. It will also allow businesses to take on unaccredited investors without as many front end costs, making it easier for businesses to start making money and in turn enabling investors to get their returns faster.

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[269] *Id.*
[270] *Id.*
[271] Miller, *supra* note 228.
[272] *Id.*
[273] Lake, *supra* note 79.
[274] *Donald Trump's Many, Many Business Dealings in 1 Map*, TIME MAGAZINE (Jan. 10, 2017), http://time.com/4629308/donald-trump-business-deals-world-map/.
[275] *See* Feldman, *supra* note 235.
[276] *Id.*
[277] *Id.*
[278] *Id.*
[279] Miller, *supra* note 228.

VIII. CONCLUSION

Access to capital is essential for business survival, the American economy, and the job growth rate. Small businesses, which amount to a vital component of the American economy, face not only structural and economic disadvantages, but also face legal obstacles in their search for essential capital to keep their businesses thriving. It is imperative that our legislature is created in a way that helps businesses flourish.

The purpose of the JOBS Act was aimed at reducing inefficient legal rules that were effecting small businesses' access to capital. The exemption from registration, however, is limited to sales to accredited investors, and that, by definition, is a limited capital market for businesses. Furthermore, the current state of the law limits unaccredited investors to participate equally in crowdfunding. Reform of the current crowdfunding act is necessary for the success of businesses and the well-being of investors.

The Fix Crowdfunding Act would enable businesses to access more capital while allowing unaccredited investors better opportunities. Amending the cap and allowing special purpose vehicles can provide more economic opportunity, facilitate better investor advice, and make real the utility of crowdfunding.[280] These changes are imperative to the future of our economy. The Fix Crowdfunding Act would fulfil the crowdfunding promises that were set out by Congress.

In the meantime, investors and businesses should take caution. Businesses should beware of strict regulations, rules, and filings. Luckily, the recent political change to the Trump Administration will hopefully alleviate some of these unnecessary restrictions. Regardless, until the Fix Crowdfunding Act is passed, investors should protect themselves against fraud and illiquidity of investments, and businesses should be cautious to use crowdfunding to raise business capital.

[280] *See Fix Crowdfunding Act*, *supra* note 5.