

# **Gdansk Social Economy Conference**

Gdansk, June 26-28, 2008

## Panel A

*Current regulations on functioning of social economy in  
Poland and postulates on how to change them*

## **Social enterprises in Europe: legal barriers and new emerging perspectives**

**Prof. Paola Iamiceli**

University of Trento

[iamiceli@jus.unitn.it](mailto:iamiceli@jus.unitn.it)

## **Non profit entities running economic activities: some policy issues.**

- ✓ Can non-profit organisations run economic activities?
- ✓ Which relationship can be established between economic and non-economic activities?
  - ✓ Can economic activity subsidise non-economic activity?
  - ✓ To what extent does tax policy influence this divide?
- ✓ How could these organisations be financed?
  - ✓ Could internal and external financing be promoted through a limited distribution of profits or other forms of remuneration?

*A brief overview of some European legal systems  
(mainly: France, United Kingdom, Belgium, Italy)*

## Some preliminary remarks about non-profit entities regulation at large

- ✓ For many years the debate on the so called Third sector has been focused on the **non-distribution constraint** as the main source of identity for the organisations operating in this sector (among others: Salamon, Hansmann)
- ✓ The current state of the legal and economic debate not only includes a partial distribution allowance
- ✓ but also tends to focus on the finality of the organisations as the main source of their identity as **social purpose organisations and enterprises** (among others: Borzaga – Defourny, Emes networks, Oecd)

*(Continues)*

*(continued)*

- ✓ Having regards to the legal perspective as well as to the real functioning of these organisations, it is important not to overlap the following profiles.
  - ✓ **Finality (I):** an organisation may be principally directed to pursue social aims (e.g. supporting elderly) or not (e.g. providing financial services to ordinary enterprises)
  - ✓ **Finality (II):** when the organisation does not principally pursue a lucrative aim (generating and distributing of profits), the rule concerning the allocation of profits does not regard the organisation's finality anymore (unless in negative terms) but the characteristics of the financial structure (total v. partial distribution constraint)
  - ✓ **Activity:** it may involve or not economic activity; such economic activity may present or not the characteristics of an entrepreneurial activity

*(continues)*

*(continued)*

- ✓ More specifically, in legal terms, an organisation is considered an **enterprise** if this organisation not only carries on economic activity, but if:
  - ✓ such activity involves a complex organisation based on a specific set of persons and assets devoted to it;
  - ✓ it is not temporary or occasional;
  - ✓ it represents the main activity carried on by the organisation;
  - ✓ the balance between costs and revenues, with or without generating profits, allows a continuity of this activity avoiding dependence upon external financial resources.

## **The different functions and domains of legislation**

- ✓ Given these preliminary remarks, it is useful to distinguish between:
  - (a) legislation regulating non-profit entities which, by legal definition, do not carry any economic activity (or do it only marginally)
  - (b) legislation regulating non-profit entities without any specific reference to the type of activity (economic or not), provided that the NDC is respected
  - (c) legislation regulating non-profit entities which, by legal definition, carry on (social purpose) entrepreneurial activity as their main activity

*(continues)*

*(continued)*

- ✓ Very roughly the three options also tend to describe the evolution of many legal systems in Western Europe:
  - ✓ starting from quite a *restrictive* approach towards the economic dimension of non-profit entities (a),
  - ✓ going through a legal approach inclined to *tolerate* this dimension, although without a recognition of the social and economic value of social enterprises (b),
  - ✓ heading to this recognition with a legislation focused on social enterprise as such (c).

# A brief overview of some European legal systems

## Can non-profit organisations run economic activity?

### France

- ✓ *Associations (law July 1, 1901)* – no explicit limit in civil regulation; commercial activity is discouraged at a tax level (loss of tax advantages)
- ✓ *Société Co-opératif d'Intèrêt Collectif (SCIC)* – law of July, 17, 2001, n. 624: this engages in entrepreneurial activity by definition

### United Kingdom

- ✓ *Charities*: commercial activity is not prohibited as such provided that it is finalised to pursue charitable aims; however the “charitable purpose test” is intended as more restrictive than under the Cics’ regulation
- ✓ *Community Interest Company - Companies – Audit, Investigations and Community Enterprise – Bill (2004, in force since July 2005)*: eligible all companies that carry on activities for the benefit of the community or activities which are incidental to these.

### Belgium

- ✓ *Associations sans but lucratif*: they cannot engage in industrial and commercial transactions (art. 1, law 27 June 1921 as modified by law 51/2002)
- ✓ *Société a finalité sociale (SFS)* - reform of company code by law of April 13, 1995: this engages in entrepreneurial activity by definition

8  
(continues)

*(continued)*

## **Italy**

- ✓ *Associations and Foundations in general* (see civil code): no express constraint; most courts and legal scholars hold that these organisations can operate as enterprises (also before l.d. 155/06); however, limits emerge in sectorial legislation (see below)
- ✓ *Voluntary organisations*: commercial and productive activities are allowed insofar marginal
- ✓ *Non governmental organisations*: commercial activities are considered by the law as incidental
- ✓ *Social promotion associations*: commercial, artisan, agricultural economic activities are considered by the law as auxiliary and subsidiary and anyway aimed at pursuing institutional goals
- ✓ *Non-commercial entities* (tax law): commercial activities may not prevail over the non-commercial institutional activity of the entity
- ✓ *Onlus* (tax law): limits in production and distribution of goods and services (either provided to disadvantaged people or kept within a quantitative range over the total expenses)

*[See below for further details]*

- ⇒ *To this extent, economic activity by non-profit organisations is more “tolerated” than recognized*
- ⇒ *Economic activity is considered as incidental and/or marginal but not the main activity of these organisations*

*(continued)*

- ⇒ *Differently, other laws recognize the role of social enterprise as such*
- ✓ *Social Co-operatives (law 281/91): these operate as SEs;*
    - ✓ *these co-operatives aim at satisfying the community's general interest in human promotion and social integration:*
      - ✓ *by providing educational, social and health-care services ("type A – co-operative")*
      - ✓ *or by carrying other (agricultural, industrial, commercial, services supply) activities with a scope of integrating disadvantaged people into working life ("type B – co-operative")*
  
  - ✓ *Social Enterprise (l.d. 155/2006):*
    - ✓ *any kind of private organisation (e.g., associations, foundations, co-operatives, non-co-operative companies) which permanently and principally operates an economic activity aimed at the production and distribution of social benefit goods and services while pursuing general interest goals*
    - ✓ *the entrepreneurial activity is considered as the "main activity" if 70% of the enterprise's revenues derive from such activity*

## Which relationship can be established between economic and non-economic activities?

- ✓ The issue does not regard organisations whose mission is:
  - ⇒ to pursue social interests aims by the means of an economic activity as the sole activity (by definition the “charter” activity is characterised as aimed at pursuing economic *and* social interest)
  
- ✓ It does regard organisations that pursue their social goals through:
  - ✓ economic and non-economic activities (e.g.: a foundation awarding subsidies to elderly, organising conferences on elderly health-care and commercializing books on elderly)
    - ✓ non-economic activity may be prevalent or not with respect to the others (**quantitative divide**)
    - ✓ economic activity may serve to merely finance the “charter” activity or substantially contribute to pursue the social mission (**qualitative divide**)

*(continued)*

- ✓ Legal systems tend to restrict commercial activity by non-profit organisations:
  - ✓ to ensure the compliance with the social purpose or public benefit test (then the law normally requests the economic activity to be destined to pursue the same goals) and/or:
  - ✓ for tax purposes (to align for-profit and non-profit organisations under “similar” respects)

*(continues)*

**(continued)**

**The case of Italian laws on Non-profit organisations (civil and tax law)**

- ✓ *Voluntary organisations* (l. 266/91 – fiscal benefits) may finance their own activity through fee-charging activities if marginal (e.g.: occasional sales during festivities, sale of products manufactured by volunteers or given as a gift by third parties, services supplied at a fee not higher than 50% of their cost)
- ✓ *Social promotion associations* (l. 383/00 – fiscal benefits): may receive fees from goods or service supply to members and non-members also by the means of economic activity if auxiliary, subsidiary and directed to pursue institutional goals
- ✓ *Onlus* (l.d. 460/91, tax law – fiscal benefits) may carries on activities *different from* the ones legally defined (by reference to field of activity and other criteria) if not prevailing over the charter ones and if their costs do not exceed by 66% the total expenses of the organisation
- ✓ *Non-commercial entities* (tax law – fiscal benefits): commercial activities may not prevail over the non-commercial institutional activity of the entity
- ✓ General rule for religious, social promotion, cultural, charitable associations: revenues for sales of goods or services to members are not considered as commercial revenues (tax exempt).

## How could these organisations be financed? Could investments and financing be remunerated?

### *General trends (associations and foundations)*

- ✓ Associations and foundations are regulated as not-for-profit organisations
- ✓ In some countries (e.g. Italy) they may establish for-profit companies and receive their profits, provided that they do not distribute them among members or alike
- ✓ Associations' members do finance the organisation through periodic contributions, but these contributions are not generally intended as forms of financing and/or investment and they cannot normally be returned to members at the time of exit/withdrawal
- ✓ Associations and foundations do not normally issue financial instruments

### *On the contrary:*

- ✓ See French Financial and Monetary Code (art. L 213.8 ff., as modified in 2003): associations that have indeed carried on economic activity for at least two years may issue financial instruments (*obligation, titre associatif*) due to be remunerated at a capped rate (not more than the average market rate for "obligations" during the three months before the issue)
- ✓ In the area of legislation on social cooperatives and social enterprises a limited remuneration of **financial instruments** is allowed under certain legal systems (UK, Italy, see Panel E)

*(continues)*

- ✓ The financial structure of a non-profit organisation (mainly: the alternative between internal and external financing, between repayable or not repayable contributions, between remunerated and not remunerated financing) strongly depends on:
  - ✓ the nature of the organisation's activity (being it economic or not);
  - ✓ the continuity of this activity;
  - ✓ the organisation's ability of internally generating revenues;
  - ✓ its ability of being accountable vis à vis third parties on a financial and operational level
- ✓ Several economic and legal scholars today tend to abandon the prejudice against remuneration with respect to non-profit organisations and hold that such remuneration may represent a source of financing for non-profit entities engaging in entrepreneurial activities
- ✓ While allowing a (limited) remuneration, legislation should also provide financiers and third parties beneficiaries with sufficient guarantees in terms of accountability, the soundness of the assets, the well-functioning of the governance structure.

# Hints for discussion: envisioning a law on social enterprise?

- ✓ In absence of a specific legislation on social enterprise the barriers to its emergence are
  - ✓ not only direct (e.g. limits to revenues or fee-charging),
  - ✓ but also indirect (e.g. limits concerning financial investments, employment contracts, public procurement, etc.)
  
- ✓ In order to reduce or demolish these barriers
  - ✓ not only an explicit legal recognition of the role of social enterprise would help,
  - ✓ but also a complementary regulation enabling the different “components” of SE to be put into action in a comprehensive and consistent institutional framework.
  
- ✓ **Different needs of regulation arise considering whether**
  - ✓ **(I) allowing/promoting economic activity by non-profit organisations is intended as a way to facilitate their financing methods, merely, or**
  - ✓ **(II) the policy objective is to promote a distinctive entrepreneurial role of NPOs in the social economy**

*(continues)*

*(continued)*

- ✓ Should a possible new regulation on NPOs and social enterprises be “public” (voted by the Parliament or alike) or could self-regulation have a (complementary) role under this respect?
- ✓ How should tax and “civil” law interact? Should the law be primarily tax-related?
- ✓ Which type of coordination should be established between a possible law on social enterprise and the law on non-profit organisations as differently qualified?