This is Not Legal Advice!

- Stephanie – I do NOT practice law
- F.J. Practices Law, but only offers Legal Advice to his Clients

Purpose of Today’s Session:
- To Make You a Better Consumer of Legal Services, Saving you Time and Money
What Is a Social Enterprise?

- A "social enterprise" is defined as “a business that directly addresses a social need through its products and services.”

  Jerr Boschee,  
  Adjunct Professor  
  CMU's Heinz College
Reasons for Founding a Social Enterprise

- Do something positive with your professional/working life.

- Other Possible Reasons
  - Customers consider social and environmental impact
  - Investors Consider social and environmental Impact
  - Foundations Fund Some Social Enterprises
What Legal Entity Should My Social Enterprise Be?

- Non-Profit
- For-Profit
- Hybrid
- Combination

What are the Costs and Benefits of Each?
Non-Profit

Mission-Based Organization

- Benefits
  - Tax Deduction for Charitable Contributions
  - Eligible for Foundation Grants
  - Legally Able to Use Unpaid Volunteers
Costs of Non-Profit Status

You Don’t Own it – the Public Does!

- You Can’t Make a Profit
  - Non-profits Can Pay You a Reasonable Salary and Reimburse Legitimate Expenses
  - But You Can’t Share in Financial Upside
  - Serious Penalties for Private Inurement and Conflicts of Interest
Another Cost of Non-Profit Status

You Don’t Make the Decisions!
A Board of Directors (Acting for the Public) Makes the Decisions

- This Includes The Decision as to Whether to Hire or Fire You and the Rest of the Staff
- Founders’ Syndrome
Administrative Burdens

**Public Filings**
- Initial Filing
- Annual Return
  - Includes Disclosure of all Potential Board Conflicts of Interest

**Grant Reporting**
For-Profit

- **Benefits**
  - You Can Make a Profit!
  - You Can Make the Decisions

- **Costs**
  - No Tax Deductions for Contributions
  - No Unpaid Volunteers
  - Must Focus on Maximizing Profit for Owners
    - Social Benefit is secondary consideration
Hybrid Entities – Combine Profit with Purpose

The Best of Both Worlds?
Yes, in that Company Combines Profit with Purpose
- Can Earn Profit
- Can Consider Purpose in Decision Making

However:
- No Charitable Deductions for Contributions
- No Unpaid Volunteers
- Fewer Grant Opportunities
Complications

- Different States Have Different Hybrid Corporate Forms
- Benefit Corporations, Flexible Purpose Corporations and L3Cs are the Most Common Forms
- Approximately 26 States, including PA, have Some Version of a Benefit Corporation Statute
- Flexible Purpose Corporations and L3Cs (Low-Profit LLC) DO NOT exist in PA
Combination

- A Non-Profit Can Own A For-Profit
  - The For-Profit Subsidiary is Disregarded Entity (i.e., Neither the Non-Profit nor the For-Profit Pays Taxes so long as they Act in line with Non-Profit Mission)

- Fiscal Agency Relationships
  - For Profits Can Sometimes Get Grants by Working with Non-Profit Fiscal Agents (but there is usually a fee, sometimes as high as 15%)
B-Corp Certification (www.bcorporation.net)

- **Voluntary Certification, NOT Legal Structure**
  - Can Be Applied to Any Legal Structure
  - Periodic Assessments and Must Publish Results
  - Requires addition of language to Bylaws/Operating Agreement
  - No difference in Tax Treatment
What Entity is Right for Me?
Suggestions – NOT Legal Advice

**LLCs** are often best for Start-Up Social Enterprises

- Most flexible
- Least amount of filings
- No required shareholders’ meeting
- Pass through taxation treatment
LLCs Formed for Social Enterprise:

What’s Different?

- Formation
- Management
- Public Reporting
Formation:

- **Certificate of Organization**
  - Should state specific public benefit (like non-profit mission)

- **Operating Agreement** - Should Include:
  - Public benefit purpose
  - Special management duties
  - Reporting of public benefit information
Special Management Duties:

- Manager(s)/Management Committee should take social benefit into account on all decisions

Reporting of Public Benefit Information:

- Annual Assessment by Third Party
Other Considerations in Using LLC for Social Enterprise

**Tax Status:**
- Flow Through Tax Status (no separate return – appears on your personal return)
- No reduced tax rate

**Raising Capital:**
- No difference – Both Debt & Equity Financing are OK
- Seek Groups looking to Fund Social Benefit Aspects
Challenges for For-Profit Social Enterprises

- More complicated mission (need to succeed as social enterprise and business enterprise)
- Often want benefits of nonprofits while being for profit (e.g., unpaid volunteers)
- Investors may be wary about funding unfamiliar type of entity (e.g., PA benefit corporations)
Thank you

Questions?