Legal Considerations for Social Enterprises

Stephanie Ann Dangel
Oded Green
Eryn Correa
OUTLINE

- What is a Social Enterprise?
- Choice of Entity
  - For Profit
  - Benefit Corporation
  - Not-For-Profit (or Non-Profit)
- B Corp Certification
- Fund Raise
- Management
- What’s Good for Me?
WHAT IS A SOCIAL ENTERPRISE?

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

- Jerr Boschee, Adjunct Professor, CMU Heinz College
RISE IN SOCIAL ENTREPRENEURSHIP

- Blake Mycoskie, founder of Tom’s shoes, pledged $100M to fund social enterprises
- President Barack Obama in his State of the Union Address promised to lift up business that are “doing right” by their employees
- Mark Zuckerberg pledging 99% of Facebook shares to philanthropic causes
- Rise in companies such as Warby Parker, the Honest Company, Thread
REASONS FOR FOUNDING A SOCIAL ENTERPRISE

- Do something positive
  - Community
  - Welfare
  - Environment
- Economic Benefit
  - Customers
  - Investors
- Available Funding
  - Foundations
FOR-PROFIT ENTITY CHOICES

- Three “REAL” choices
  - C Corporation
  - S Corporation
  - Limited liability company

- Others
  - Sole Proprietorship
  - Partnerships
  - Limited Partnerships
# FORM OF FOR-PROFIT ENTITY: CONSIDERATIONS

<table>
<thead>
<tr>
<th>Corporation*</th>
<th>Limited Liability Company</th>
<th>S Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No Double Tax</strong></td>
<td>✗</td>
<td>✅</td>
</tr>
<tr>
<td><strong>Flow Through</strong></td>
<td>✗</td>
<td>✅</td>
</tr>
<tr>
<td><strong>VC Acceptable</strong></td>
<td>✅</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Limitation on Shareholders</strong></td>
<td>✅</td>
<td>✅</td>
</tr>
<tr>
<td><strong>Medicare Tax Efficient</strong></td>
<td>✅</td>
<td>✗</td>
</tr>
</tbody>
</table>

*benefit corporations are taxed as corporations
CHANGING COURSE

LLC — C CORP
BENEFIT CORPORATION

- For-Profit, With a Look Beyond
- Purpose: “General Public Benefit” or a Specific One
- Adopted in 31 States (including Pennsylvania and Delaware). In the Pipeline for 5 additional States
- Taxation: May be Taxed as a C Corporation or as an S Corporation
BENEFIT CORPORATION

- Advantages
  - Great Marketing Tool
  - Strong Commitment to Social Purpose
  - Legal Protection for Directors

- Disadvantages
  - Non-Recognized Entity
  - No Legal Precedents
  - No Tax Incentives
  - Fund Raise
B CORP CERTIFICATION

- Third Party Certification
- Not a Legal Entity
- Laundry List of Requirements
  - Purpose
  - Amendment of Certificate of Incorporation
  - Annual Reporting Requirements
  - Other Burdens
B CORP CERTIFICATION

▪ Advantages
  ▪ Commitment to Social Purpose
  ▪ Access to Community of Other B Corps
  ▪ Marketing Tool for Consumers
  ▪ Does Not Intimidate Investors

▪ Disadvantages
  ▪ No Tax Incentives
  ▪ Burden; Stringent Requirements
What Is a Non-Profit Organization?
- An organization formed under a state’s nonprofit corporation statute
- Must have a charitable purpose (as described in the tax code) in order to qualify for tax-exempt status

How Do I Form a Non-Profit?
- Two step process:
  - Incorporate under state nonprofit corporation
  - Apply for tax-exempt status (both federal and state)

Structure
- Like a corporation, a Board of Directors oversees the management, but the board’s obligation is to the general public (as opposed to shareholders)
NOT-FOR-PROFIT ENTITIES

Advantages
- Mission-based organization
- Tax deductions
- Foundation grants
- Legally able to use unpaid volunteers
NOT-FOR-PROFIT ENTITIES

- **Disadvantages**
  - You do not own it – the public does!
  - You cannot make a profit
    - Non-profits can pay you a reasonable salary and reimburse legitimate expenses
    - You cannot share in the financial upside/success of the organization
    - Serious penalties for private inurement and conflicts of interest
NOT-FOR-PROFIT ENTITIES

- Management
  - You do not 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
NOT-FOR-PROFIT ENTITIES

- Administrative Burdens
  - Public filings
    - Initial filing
    - Annual return
      - Includes disclosure of all potential board conflicts of interest
  - Grant reporting
WHAT ENTITY IS GOOD FOR ME?

- It Depends…
  - What Is My Purpose?
  - Funding
  - Management
  - Tax
  - Flexibility
  - Administrative Burdens
QUESTIONS?

Thank you!