Legal Considerations for Social Enterprises

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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
REASONS FOR FOUNDING A SOCIAL ENTERPRISE

- Do something positive
  - Community
  - Welfare
  - Environment
- Economic Benefit
  - Customers
  - Investors
- Available Funding
  - Foundations
INVESTMENT IN A SOCALLY RESPONSIBLE ENTERPRISE (IMPACT INVESTMENT)

- An investment intended to generate positive social and/or environmental impact and generate financial returns involving a diverse group of investors.
FOR-PROFIT ENTITY CHOICES FOR
SOCIALLY RESPONSIBLE ENTITIES

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

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

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<th>Corporation*</th>
<th>Limited Liability Company</th>
<th>S Corporation</th>
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*benefit corporations are taxed as corporations
CHANGING COURSE

LLC → C CORP

Wrong → Right
FOR-PROFIT STRUCTURE FOR A SOCIALLY RESPONSIBLE ENTITY

Advantages

- Familiarity of Investors with the Structure.
- Predictability / Available Case Law
- Flexibility Regarding Tax Treatment
- Branding as a Socially Responsible Entity May be Achieved Through Other Means
FOR-PROFIT STRUCTURE FOR A SOCIALLY RESPONSIBLE ENTITY

- Disadvantages
  - Branding/Public Perception
  - Director Liability / Corporate Law Protection
  - Limited Flexibility for the Board in Case of Sale of the Company
THE UNIVERSE OF HYBRID ENTITIES

- For-Profit, With a Look Beyond
- Purpose: “General Public Benefit” or a Specific One
- Adopted in 31 States (including Pennsylvania and Delaware)

- Universe of Hybrid Entities:
  - Benefit Corporations/Companies
  - Low Profit Limited Liability Companies (LC3)
  - Others

- Taxation: May be Taxed as a C Corporation, Partnership or as an S Corporation
BENEFIT CORPORATION

- Advantages
  - Great Marketing Tool
  - The Sustainability Factor
  - Strong Commitment to Social Purpose
  - Legal Protection for Directors
  - Flexibility for the Board in Case of Sale of the Company

- Disadvantages
  - Investor Hesitancy / Raising Funds
  - Legal Uncertainty/No Legal Precedents
  - Additional Reporting and Disclosure Requirements
  - No Tax Incentives
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 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 statute
  - Apply for tax-exempt status (both federal and state)
NON-PROFIT 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-PROFIT ADVANTAGES

- Mission-based organization
- Tax deductions
- Legally able to use unpaid volunteers
- Foundation grants
NON-PROFIT 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
MORE NON-PROFIT DISADVANTAGES

- **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**
MORE NON-PROFIT DISADVANTAGES

- Administrative Burdens
  - Public filings
    - Initial filing
    - Annual return
      - Includes disclosure of all potential board conflicts of interest
  - Grant reporting
- You Cannot Engage in Political Activities
FOR-PROFIT/NON-PROFIT HYBRID ENTITIES

- FOR-PROFIT WITH RELATED NON-PROFIT FOUNDATION
- NON-PROFIT WITH FOR-PROFIT SUBSIDIARY – DISREGARDED ENTITY
- FISCAL AGENCY RELATIONSHIP

- BUT REMEMBER – ONCE YOU ARE A NON-PROFIT, YOU CAN ONLY TRANSFER ASSETS TO ANOTHER NON-PROFIT
- IF YOU ARE A FOR-PROFIT, YOU CAN TRANSFER ASSETS TO A NON-PROFIT (so long as it’s all right with the owners!)
WHAT ENTITY IS GOOD FOR ME?

It Depends…

- What Is My Purpose?
- Funding
- Management
- Tax
- Flexibility
- Administrative Burderns
QUESTIONS?

Thank you!