Legal Considerations for Social Enterprises

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OUTLINE

- What is a Social Enterprise? Why?
- 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
  - Impact Investors
WHAT IS IMPACT INVESTING?

An investment intended to generate positive social and/or environmental impact and generate financial returns involving a diverse group of investors.
IMPACT INVESTING

- **Global assets** professionally managed under sustainable and responsible investment strategies soared to **$23 trillion** in 2016, a 25% increase from 2014. Responsible investment now accounts for 26% of all professionally managed assets globally, according to the review.

- More than one out of every five dollars under professional management in the **United States**—$8.72 trillion or more—was invested according to Socially Responsible Investment strategies.
ARE THERE IMPACT INVESTORS IN PITTSBURGH?

▪ YES & NO
  ▪ YES, PITTSBURGH FOUNDATIONS make PRIs (Programmatic Regional Investments)
  ▪ Yes, “CIVIC-MINDED” INVESTORS make socially and environmentally motivated investments to benefit the Pittsburgh Region

▪ BUT, They don’t call themselves Impact Investors
FOR-PROFIT ENTITY CHOICES

- Three “REAL” choices
  - C Corporation
  - S Corporation
  - Limited liability company
- Others
  - Sole Proprietorship
  - Partnerships
  - Limited Partnerships
CORPORATIONS

Shareholders

Corporation

LIMITED LIABILITY COMPANIES

Members

Limited Liability Company
FORM OF FOR-PROFIT ENTITY CONSIDERATIONS

<table>
<thead>
<tr>
<th>Corporation*</th>
<th>Limited Liability Company</th>
<th>S Corporation</th>
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<td><strong>Flow Through</strong></td>
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<td><strong>Medicare Tax Efficient</strong></td>
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*benefit corporations are taxed as corporations
CHANGING COURSE

LLC  C CORP

- Yes
- No
FOR-PROFIT STRUCTURE FOR A SOCIALLY RESPONSIBLE ENTITY

- **Advantages**
  - Familiarity of Investors with the Structure.
  - Predictability / Available Case Law
  - Flexibility Regarding Tax Treatment
FOR-PROFIT STRUCTURE FOR A SOCIA LLY RESPONSIBLE ENTITY

Disadvantages

- Branding/Public Perception (although For-Profit can achieve socially responsible branding through other means)
- 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 37 States (including Pennsylvania and Delaware).
  - Benefit Corporations/Companies (34 States, including PA and Delaware; 6 Pending)
  - Benefit LLCs (3 States, including PA)
  - Low Profit Limited Liability Companies (LC3) (8 States, 4 Pending)
  - Social Purpose Corporations (4 States)
- Taxation: May be Taxed as a C Corporation, S Corporation, LLC or Partnership
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
BENEFIT LLC

- Three States: Pennsylvania, Maryland and Oregon (pending in Connecticut)
- Advantages/Disadvantage Benefit LLC v. Benefit Corporation

- Map of Different State Social Enterprise Entities
  - [http://socentlawtracker.org/#/map](http://socentlawtracker.org/#/map)
EXAMPLE OF FOR-PROFIT & HYBRID ENTITY: THREAD INTERNATIONAL

• Began as Pennsylvania For-Profit
• Switched to Delaware Benefit Corporation
• Why?
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
NOT-FOR-PROFIT ENTITIES (NON-PROFITS)

- **What Is a Non-Profit Organization?**
  - An organization formed under a state’s nonprofit corporation statute
  - To qualify for tax-exempt status, must have a charitable purpose (as described in the tax code)
NON-PROFITS

- How Do I Form a Not-For 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

- FISCAL AGENCY RELATIONSHIP
- FOR-PROFILE WITH RELATED NON-PROFILE FOUNDATION
- NON-PROFILE WITH FOR-PROFILE SUBSIDIARY
  - DISREGARDED ENTITY FOR TAX PURPOSES
  - CAN GET SUBSIDIARY B CERTIFIED
- BUT REMEMBER – ONCE YOU ARE A NON-PROFILE, YOU CAN ONLY TRANSFER ASSETS TO ANOTHER NON-PROFILE
- IF YOU ARE A FOR-PROFILE, YOU CAN TRANSFER ASSETS TO A NON-PROFILE (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 Burdens
QUESTIONS?

Thank you!