



## BETTER ENTREPRENEURSHIP ONLINE TOOL

### GUIDANCE NOTE: LEGAL & REGULATORY ASPECTS

#### Introduction

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Law and regulation within a given country have an increasingly significant influence on the visibility of social enterprises and as key enablers of social enterprise development.<sup>1</sup> The way social enterprises are interpreted in legal and regulatory terms differs from country to country. In some countries, the concept of social enterprise, if it is legally recognised at all, is interpreted very narrowly, which can mean only certain legal forms, such as a co-operative or an association, or only certain forms of social mission, such as worker integration. Whereas other countries with more mature social enterprise traditions typically recognise that social enterprises may take on a wide variety of legal forms, such as associations, foundations, co-operatives and companies, and a wide variety of social missions, which can range widely, for example, from protecting the environment to promoting financial inclusion.

In countries where the law does not recognise social enterprises, it is typically very difficult to tell which business are genuine social enterprises and which are not. As a result, there are often few or no official statistics about the number of social enterprises or their rate of incorporation, growth, sectors of activity, or insolvency. In such countries, it is usually difficult to provide any kind of policy incentives or target support towards social enterprise development, as social enterprises are largely invisible within the overall body of businesses in the economy and cannot easily be identified or differentiated. These social enterprises are sometimes described as “*de facto*” social enterprises, which operate as social enterprises in practice but which are not easy or possible to distinguish legally from other businesses.

As all social enterprises must operate through one or more legal forms, the underlying legal forms are the primary building blocks of social enterprise. If the legal forms available are not suitable for social enterprise activity then it will be much more difficult for a vibrant and broad-based local social enterprise dynamic to develop to its full potential. In some jurisdictions, there are restrictions, for example, on not for profit organisations taking a foundation or an association legal form from trading or from establishing subsidiaries for the purpose of trading. In other countries, there are no established models for share companies prioritising social mission.

In countries where the law does recognise and support social enterprises, the law sometimes adapts individual legal forms to create tailor made or specific models which are ideal for use by social enterprises, such as with the “social purpose company” in Belgium or the “*société d'impact sociétal*” in Luxembourg or the “community interest company” in the United Kingdom.

In some instances, these tailored legal forms are regulated by an external regulator which ensures that the social mission is primary and that the legal form is not abused in practice. In other instances, there is no external regulation but there are model forms of constitution which individual social enterprises

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<sup>1</sup> See, for example, [Social Enterprises and the Social Economy Going Forward](#), published in October 2016 by the European Commission’s Expert Group on Social Entrepreneurship.

can adopt to use an existing legal form for a social mission. The presence of adapted legal forms that are tailored for social enterprises reduces transaction costs and the difficulty of choosing legal forms for social enterprises starting up, increases the visibility of social enterprises and makes it easier for policymakers and funders to identify and support social enterprises.

In certain jurisdictions, the law creates a legal status that recognises social enterprises operating under a variety of different legal forms. This status may require registration with the government on a centralised register of social enterprises and it may bring with it tax or other privileges or exemptions. Examples of such social enterprise statuses include the French law on the “social and solidarity economy”, which is available to any legal form meeting the criteria set out in the law for a social and solidarity economy enterprise, and Italy’s law which recognises social enterprises using a variety of legal forms as being social enterprises “ex-lege”.

Arguably, the “ideal” legal and regulatory system is one which combines:

(a) a range of legal forms which exist and have been adapted and are suitable for use by social enterprises which prioritise social mission above profit, including social enterprises operating using non-profit distributing, co-operative and share company legal forms; and

(b) a social enterprise legal status which is available to social enterprises operating through one of a variety of different legal forms and which brings with it appropriate tax and other reliefs or privileges which reflect the fact that the social enterprise prioritises social mission above returns to investors.<sup>2</sup>

## **Recommendations for policy actions**

### ***Policy levers***

- ✓ Consider whether it is possible to ***positively adapt*** existing legal forms ***within the framework of existing legislation*** for use by social enterprises, such as by creating “model form” constitutions (i.e. pre-drafted governing documents which are ready for use) for different legal forms which are adapted to prioritise social mission and which therefore form ready starting points for use by social entrepreneurs.
- ✓ Think about whether there are particular legal forms which are not currently being used by social enterprises in the jurisdiction and whether any ***specific barriers need to be removed*** to make the relevant legal forms usable, including potentially by removing or changing restrictions or barriers ***set out in law or regulation***.
- ✓ Recognise that law and regulation is complex and a long- term approach is desirable, if social enterprises are to be mainstreamed into the development of law and policy generally.

### ***Pitfalls to avoid***

- ☒ Do not think that a single “social enterprise law” is the silver bullet and will solve all problems.
- ☒ Do not design legal forms that are unduly restrictive and unattractive to entrepreneurs.

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<sup>2</sup> See [Social Enterprise in Europe: Developing Legal Systems Which Prioritise Social Enterprise Growth](#) published by the European Social Enterprise Law Association in October 2015 for a more detailed discussion and explanation of the difference between “legal forms” and “legal status”.

- ☒ Do not think that a single overarching legal status, such as a “social enterprise” status that is available to a number of legal forms, is enough on its own without suitable legal forms<sup>3</sup>.
- ☒ Do not draft legislation before mapping and understanding your national and local context.

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<sup>3</sup> A ‘legal status’ attaches to a number of legal forms and is typically tax driven. Examples include charitable or not for profit statuses, work integration statuses and social enterprise statuses.

## Guidance per indicator

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### 3.1 Social enterprises are recognised in the legislation.

*Why is it important?*

We invite you to consider the extent to which social enterprises are recognised in the legislation. Is it possible to adapt existing legal forms in a way that is dedicated to social enterprises? Alternatively, have dedicated social enterprise legal statuses been developed in order to identify and support social enterprises using different legal forms?

All social enterprises must adopt a legal form in order to be able to operate and enter into contractual relationships. As a result, all social enterprises must operate within a legal and regulatory context. It is possible to adapt legal forms in a way dedicated to social enterprises and to support entrepreneurs to operate for a social mission and to prioritise the social mission above other interests. It is also possible to use dedicated social enterprise legal statuses or registration systems to identify and in turn support social enterprises using different legal forms.

Moreover, in theory, it is possible to use and adapt a wide variety of legal forms for social enterprises. In practice, in many countries, many legal forms are subject to unnecessary barriers which prevent their use and adaptation by social enterprises, such as blanket restrictions preventing certain legal forms from engaging in trading activity or preventing the establishment of trading subsidiaries or the payment of boards of directors, and which present social entrepreneurs with difficult choices. Often, these restrictions apply to legal forms that are not-for-profit in nature. In other countries, a wide variety of legal forms is available and used by social enterprises.

*Pointers to help tick the appropriate score*

In order to score high, in your territory:

- The legislation effectively recognises, differentiates, and supports social enterprises.
- There is (are) specific legal form(s) dedicated to social enterprises.
- Social enterprises can operate through a wide variety of legal forms (i.e. not dedicated to social enterprises).

#### **Good practice example**

##### ***The Law on the Social and Solidarity Economy (France)***

The French law n. 2014-856 on the Social and Solidarity Economy entered into force on 31 July 2014 (“ESS law”). The ESS law has defined the values of social and solidarity economy entities regardless of their legal form. It applies to co-operatives, foundations, associations, commercial companies and other legal forms, which now are able to apply to receive the ESS Enterprise status.

According to article 1 of the ESS law, a “Social and Solidarity Economy Enterprise” (“ESS Enterprise”) must have a democratic governance, must pursue a purpose other than sharing profits,

and must devote the majority of its profits to the objective of maintaining or developing the enterprise's social mission. The law also created a new legal status whereby any legal form may apply for the title "Entreprise Solidaire d'Utilité Sociale" (ESUS). In order to become a ESUS, the ESS Enterprise must satisfy two additional requirements: 1) the compensation for managers and employees must be capped at a prescribed level and the salary for the highest paid employee or manager cannot exceed 10x the minimum wage; and 2) the social mission must significantly impact the profits of the company according to prescribed criteria by limiting dividend distributions and payment of interest.

*For further information, please [click here](#)*

### **3.2. Legislation on social enterprises is pertinent and has been developed together with relevant stakeholders.**

*Why is it important?*

We invite you to examine the content of the legislation on social enterprises and the process through which it has been developed. Has the legislation been developed through a consultation process, which was designed to ensure that the views and interests of different stakeholders are taken into serious consideration? Does the legislation clearly identify the key features of social enterprises? Finally, does it explain the activities that social enterprises can pursue without impeding their development and growth?

Along with the content, the process for developing the legislation dedicated to social enterprises is important. A consultation is a process by which government invites relevant stakeholders to participate in the design and/or final form of a dedicated legislation or legislation affecting social enterprises, which is designed to ensure that the views and interests of different stakeholders are taken into account in an appropriately sensitive, measured and proportionate way and, ultimately, with a view to informing and enhancing the design and implementation of law and policy in the real world. Countries apply various consultation principles to the different stages of the development of law and policy.

*Pointers to help tick the appropriate score*

In order to score high, in your territory:

- The content of the legislation was developed through a consultation process.
- The legislation provides a definition and presents the key features of social enterprises.
- The legislation sets out the activities that social enterprises can pursue.

### **3.3. Administrative procedures for facilitating social enterprise development are accessible and clear.**

We invite you to assess how easy it is to establish a social enterprise. Is the information regarding the procedures and the paperwork for establishing a social enterprise clearly signposted and easy to understand by the prospective social entrepreneurs?

*Why is it important?*

As every social enterprise must choose and establish a legal form of one kind or another, social entrepreneurs need information to understand which legal forms to use and how such legal forms can be used or adapted to prioritise social mission. In addition, information regarding the procedures and the paperwork for establishing a social enterprise needs to be clearly signposted and easy to understand by the prospective social entrepreneurs. Different countries have different ways for presenting and communicating this piece of information.

*Pointers to help tick the appropriate score*

In order to score high, in your territory:

- Information for establishing a social enterprise is easy to access.
- Information on administrative procedures is easy to understand.

### **3.4. Fiscal incentives are provided to actors who support social enterprises financially.**

We invite you to consider the extent to which fiscal incentives are provided to actors that finance social enterprises. Do investors, who are willing to provide risk capital to social enterprises, receive any fiscal rewards, such as tax reliefs? Are tax incentives being provided for philanthropic and investment support to social enterprises?

*Why is it important?*

Many social enterprises face barriers when raising finance, as they often reinvest the majority of their profits and many operate in broken or underserved markets where generating a profit is difficult. As a result, special funds, such as grant funding programmes or specialised investment funds or development funding, are often established to make finance available to social enterprises and different countries take different approaches to the taxation of such funds.

To provide incentives for this type of investments, there is scope for developing lighter regulation, and tax incentives associated with the funding of social enterprises. Whereas philanthropy is often subject to a lighter regulation, sometimes associated with tax incentives, investment in social enterprise often falls within full market regulated investment. Therefore, policymakers should consider developing a third area, between philanthropy and full market regulated investment for financing social enterprises. This third area does not exist in the markets at the moment, with the exception of some emergent flexibility for crowdfunding. Still, this area of investment support for social enterprises is hindered by excessive regulation and disproportionate costs.

Furthermore, some Member States are providing greater tax incentives for philanthropic and investment support to social enterprise recognising the tax savings that these social enterprises provide. Specific examples include:

- I. Tax incentives or reliefs for individual tax payers giving money or other assets to non-profits or some forms of social enterprise: This would benefit from a further review of the corporate forms to embrace social enterprise in a way that does not create a false market advantage for trading entities. A possible solution is to have “NGO certificates” which allow individual donors to identify “reliable” NGOs (only with these ones you can use tax reliefs e.g. in Austria).
- II. The UK’s Social Investment Tax Relief, and the equivalent French Tax reliefs for investments in SMEs and social enterprises.
- III. An availability of a tax exempt status for charitable, and other asset and mission-locked entities (social enterprises).

Last but not least, many social enterprises focus on integrating disadvantaged workers, such as disabled workers or ex-offenders, into the workforce. Countries adopt different fiscal measures to address these issues.

*Pointers to help tick the appropriate score*

In order to score high, in your territory:

- The tax system appropriately rewards investors who are willing to provide risk capital to social enterprises.
- Tax incentives are provided for philanthropic and investment support to social enterprises.

### **Good practice example**

#### ***The Societal Impact Company – An Example of Fiscal Incentives for Social Enterprises (Luxembourg)***

In December 2016, Luxembourg introduced a new legal status called a société d’impact societal or social impact company (a “SIS”), which is available for any public or private company or co-operative company which meets certain requirements. These requirements include an express social purpose in the constitution of the SIS, together with key performance indicators by which the SIS will measure the advancement of its social purpose. A SIS must not exist simply for the purpose of creating value for shareholders.

The aim is to enable SIS companies to be financed by both philanthropic investors, who receive ‘impact shares’ which carry no entitlement to participate in profits, and ordinary investors, who receive ‘ordinary shares’ and are entitled to participate in profits, if the SIS’s social purpose key performance indicators (KPIs) are met. At least 50% of the shares of a SIS must be comprised of impact shares. There are also limitations on the pay of employees, on the basis of a pay ratio. The decision to approve a company as a SIS rests with the minister responsible for the social and solidarity economy in Luxembourg.

Importantly, a SIS, which has a share capital that is comprised only of impact shares, enjoys tax relief from corporation tax, local business taxes and wealth taxes and donations to such an SIS are also deductible for donors. A SIS, which is not comprised only of impact shares, is taxed like any other company.