

Legal Aspects of Social Enterprises

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What is Social Enterprise?



Fundamental Question?

- Mission-Related Investment Into An Existing Fund
- Creation of Your Own Program

Tax Consequences

- Is the Social Enterprise Charitable under Code Section 501(c)(3)?
 - combats community deterioration
 - relieves the burdens of government
 - clearly and directly advances another charitable outcome, such as promoting healthcare or education.

Tax Consequences

- Unrelated Business Income
 - The activity must be a trade or business.
 - Generally includes any activity carried on for the production of income from the sale of goods or performance of services.
 - The organization must "regularly carry on" the trade or business
 - The activity must not be "substantially related" to the organization's exempt purpose.
 - A trade or business is "substantially related" if the activity contributes importantly to the accomplishment of the organization's exempt purposes.

Tax Consequences

- Certain income is specifically excepted from unrelated business taxable income:
 - Dividends, interest, annuities & other investment income
 - Royalties
 - Rents
 - Income from research
 - Gains/losses from disposition of property

Tax Consequences

- Private Benefit/Inurement
 - Investment activity must serve public, rather than private, interests.
 - Any such private benefit must be incidental to furthering exempt purposes.
 - Generally arises with respect to compensation of managers or competitive advantage gained by for profit participation.

Meeting With Your Lawyer

- Goals/Why Social Enterprise
- Necessary Documents
- Current Compliance

Necessary Documents

- Articles of Incorporation
- Bylaws/Code of Regulations
- Determination Letter/Form 1023
- Investment Policy
- Financial Authority Policy
- Committee Charters

Current Compliance

- Corporate Compliance
 - Purposes
 - Operating in accordance with Governance Documents
 - Conflicts Policy
 - Board/Committee Meetings
 - Authority to Act
- Tax Compliance
 - Filing tax return
 - Meeting public charity test

Structure of Social Enterprise

- Internal Fund
- Single Member LLC
- Multi-Member LLC
- Tax-exempt Organization
- C Corporation
- B Corporation

Structure of Social Enterprise – Internal Fund

- Operated as a restricted fund
- Managed by EO and subject to its own policies
- EO's assets would be subject to exposure for liability
- No corporate separateness required
- Can fund only as a charitable donation

Structure of Social Enterprise – New Entity

- Distinct corporate entity with its own structure, governance, operational documents and leadership
- Managed by a separate board (may have some overlap with existing EO)
- Separate entity can help insulate EO's assets from risks associated with the social enterprise
- Would need to observe corporate formalities
- Could have outside investors and charitable donations
 - SEC compliance layer

Structure of Social Enterprise – LLC

- Articles of Organization
- Operating Agreement
 - Board of Managers
 - Fee Structure
 - Investment Purpose/Investment Policy
 - Conflict Policy
- Who Can Invest
- How Big is the Fund
- Will it Have Outside Investors

Structure of Social Enterprise – Tax-Exempt Corporation

- Articles of Incorporation
- Code of Regulations/Bylaws
- Form 1023
 - What is charitable purpose?
 - Public Charity Status
- Who Can Invest
- How Big is the Fund
- Will it Have Outside Investors

Structure of Social Enterprise – C Corporation

- Articles of Incorporation
- Code of Regulations/Bylaws
 - Board of Directors
 - Fee Structure
 - Investment Purpose/Investment Policy
 - Conflict Policy
- Who Can Invest
- How Big is the Fund
- Will it Have Outside Investors

Structure of Social Enterprise – B Corporation

- Articles of Incorporation
- Code of Regulations/Bylaws
 - Board of Directors
 - Fee Structure
 - Investment Purpose/Investment Policy
 - Conflict Policy
- Understanding the benefits
- Who Can Invest
- How Big is the Fund
- Will it Have Outside Investors

Investment/Return

- Investment Policy/UPMIFA
 - UPMIFA is a uniform act that imposes requirements when managing and investing charitable funds
 - Requirements when managing and investing charitable funds:
 - Consider the charitable purposes of the institution and the fund
 - Act in good faith
 - Use care an ordinarily prudent person in a like position would exercise under similar circumstances
 - Consider investment factors

Investment/Return

- Investment Policy/UPMIFA
 - Investment factors
 - General economic conditions, possible effect of inflation or deflation, expected tax consequences, role that each investment plays within the overall portfolio, other resources of the institution, needs of the institution to make distributions and preserve capital
 - **Expected total return from income and appreciation**
 - **An asset's special relationship or value, if any, to the charitable purposes of the EO**
 - Investment process and mission relationship are key
 - Document in Investment Policy Statement

Investment/Return

- Measuring Return
 - Market rate or reduced rate economic return
 - How do you measure social return?
 - What are you measuring?
 - What goals are you trying to achieve with investment?
 - Will not be the same for each investment

Planning and Design: What Have We Learned?

- Determine goals and define success
- Determine whether investing in funds or direct programming
- Structuring and Legal Discussions
- **Educate and Engage Board!!!**
- How will development, investment and programming staff collaborate on this effort?
- Measure economic and social impact