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Social Enterprise


Emerging Legal Structures

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Ellis M. Carter



Ellis M. Carter is the founder of the Carter Law Group P.C., in Phoenix, Arizona. Carter Law Group primarily represents nonprofit and tax-exempt organizations as well as socially responsible companies. Ellis has been selected by her peers for inclusion in Best Lawyers in America, Nonprofit/Charities law (2007-2012) and is rated “AV Preeminent” (the highest rating available) by Martindale Hubbell. Carter Law Group has been named a “first tier firm” for Nonprofit/Charities law by U.S. News/Best Lawyers.[®] Ellis is also the author and publisher of the blog, CharityLawyer, which can be read at <http://charitylawyerblog.com>.

○ ○ ○ | The Dilemma

Currently, no one U.S. legal structure
can access both philanthropic and
investment capital

○ ○ ○ | Structural Possibilities

- For-profit
- 501(c)(3)
- 501(c)(4)
- Nonprofit subsidiary of 501(c)
- Taxable subsidiary of 501(c)



Structural Possibilities

Not the
Same!

- B Corporation
- Benefit Corporation
- L3C
- Joint venture
- Contractual arrangement
- California's Flexible Purpose Corporation (Jan. 2012)



Structural Considerations

- How the SE will be controlled and governed
- Will the SE's income be taxable
- How the SE will be funded
 - Donations
 - Investments
- Risk tolerance of contributors/investors/other stakeholders
- Transparency of the SE's operations

○ ○ ○ | Obstacles to Launching Social Enterprise in NPO

- Private benefit/inurement doctrine
- Commerciality doctrine
- Unrelated business income tax
- Joint venture limitations



○ ○ ○ | Subsidiary of Nonprofit

ASU Foundation
The legacy begins with you.



ASU Venture Catalyst
ARIZONA STATE UNIVERSITY

○ ○ ○ | Why put the social enterprise in a nonprofit subsidiary?

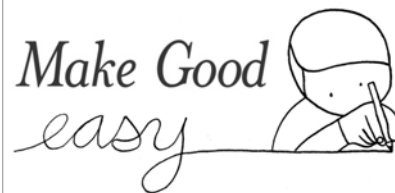
- Greater asset protection
- Opportunity to bring in separate leadership, staff, and branding
- Separate marketing and branding
- Other (property tax exemption; funding opportunities, etc.)

○ ○ ○ | Why put the social enterprise in a for-profit subsidiary?

- If taxed as a C-corp., minimizes risk to the nonprofit's tax-exempt status
- Dividends from the subsidiary may be tax free
- Greater asset protection
- Separation of leadership, staff, marketing

Emerging Hybrid Structures

- B Corporation
- Benefit Corporation
- Low Profit Limited Liability Company (L3C)
- Flexible Purpose Corporation



B Corporation Brand

- Licensing arrangement with B Labs
- B Labs created B Corp Impact Assessment and standards
- B Labs licenses the B Corp. trademarks
- Not a legal status



○○○ | B Corporation Brand

Companies can obtain license to use B Corporation trademarks if they:

- Pass B Labs rigorous assessment
- Sign Certificate of Interdependence
- Amend governing documents
- Pay fee

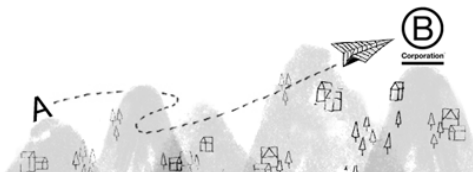


○○○ | B Corporation Brand

- Currently, B Corporations pay standard corporate income tax (Philadelphia will give B Corps a \$4,000 tax break in 2012)
- Managed and funded like a for-profit
- Net assets distributed to shareholders on liquidation

Aim Higher

*The change we seek is going from "me" to "we"
We've made it as easy as going from A to,
well, you know.*





Benefit Corporation

- Formed to pursue social purpose
- Requires social benefit director
- Requires outside third party assessment and approval
- Publish annual report
- Law in Maryland, Vermont, California, Hawaii, Virginia, New York and New Jersey

*Build a new sector
of the economy.*



Benefit Corporation

- Directors can pursue mission to the detriment of profits without breaching fiduciary duty
- Could create liability for shareholder suits for breach of duty to pursue mission

○○○ | B Corporation - Advantages

- Discounts and Freebies
- Community Support
- National Marketing Campaign



○○○ | B Corporation - Challenges

- Assessment asks over 200 questions
- Amend corporate documents
- Pay annual fee
- Recertify every 2 years
- Consent to random audits



Examples of B Corps



L3C

- Vermont, Michigan, Wisconsin, Utah, Illinois, Wyoming, Louisiana, North Carolina, Maine
- Federal legislation introduced
- Once formed in any of these states, the L3C can operate legally in all 50 states



L3C Designed to Attract



- Private investment and
- Program-related investments (“PRIs”)



Program Related Investments (“PRIs”)

Common forms of investment include:

- Interest-free or below market-rate loan
- Loan guaranty or letter of credit
- Equity investments



○ ○ ○ | PRIs

- PRIs are exception to the jeopardizing investment rules
- PRI recipients may be businesses or not-for-profits

○ ○ ○ | PRIs

PRIs Must have 3 characteristics:

- Primary purpose is charitable, educational, etc.
- No significant purpose is the production of income or appreciation of property
- No purpose is to lobby or to intervene in a political campaign

Philanthropic Facilitation Act of 2011

- Philanthropic Facilitation Act of 2011 (H.R.3420) introduced in the U.S. House of Representatives.
- If passed, the Act would simplify the utilization of program-related investments (PRIs)

L3Cs

- Primary purposes charitable or educational
- Profit-making purpose secondary
- Can elect to be taxed as corporation or partnership
- Operating agreement can vest management in members or in manager

○○○ | L3Cs

- Members contribute capital
- May be in better position to accept PRIs
- Can make distributions to members and spend money on charitable/educational programs
- Net assets distributed to members on liquidation
- Charitable contributions possible as well

○○○ | Examples of L3Cs

 Nature Returns L3C

 **REPROG**TM
renewable energy programs group L3C

 **rsb**
FUNDS, L3C

 Carolina
Ground

 **culturekettle**



L3C Activity to Date

176 L3Cs organized in Vermont (*since April 2008*)
113 L3Cs organized in Michigan (*since January 2009*)
27 L3Cs organized in Wyoming (*since February 2009*)
40 L3Cs organized in Utah (*since March 2009*)
1 L3C organized - Oglala Sioux Tribe (*since July 2009*)
75 L3Cs organized in Illinois (*since January 2010*)
30 L3Cs organized in North Carolina (*since August 2010*)
48 L3Cs organized in Louisiana (*since August 2010*)
8 L3Cs organized - Maine (*starting July 2011*)
0 L3Cs organized - Rhode Island (***starting July 2012***)

518 social entrepreneurs blazin' a path



Flexible Purpose Corporation

- Can be formed in California beginning in 2012
- Mixed profit and social purpose
- Protection from breach of fiduciary duty claims
- Publication of annual report
- No 3rd party certification





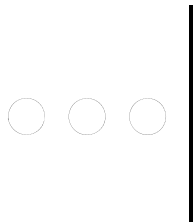
Joint Venture

- Strict rules for JV with for-profit under Rev. Rul 98-15 and related cases and rulings
- NPO must exercise governance control and have other protections
- Ongoing risk to tax-exempt status




Questions?





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