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# LEGAL FRAMEWORK FOR SOCIAL ECONOMY AND SOCIAL ENTERPRISES: A COMPARATIVE REPORT

*prepared by the  
European Center for Not-for-Profit Law*

**September, 2012**



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This report was prepared under the project “Social Economy: Innovative model of economic and social development in Slovakia” supported by the European Social Fund ([www.esf.gov.sk](http://www.esf.gov.sk)), through Operational programme Employment and Social Inclusion.

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ISBN : 978-92-95092-64-8

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## I. INTRODUCTION

### I.1. Background Information.

The European Center for Not-for-Profit Law (ECNL) has entered into an agreement with the UNDP Regional Office in Bratislava with regard to the implementation of the project: "Social Economy: Innovative Model of Economic and Social Development in Slovakia" (hereinafter referred to as: "the Project"). The Terms of Reference of the Project call for ECNL to *inter alia* prepare a report on the distinctive features of the legal framework for social economy/social enterprises in the five European Union (EU) countries. According to the TOR, the Report should cover three major objectives: 1) presentation of key features of the social enterprise sector in the target countries; 2) presentation of relevant policies and measures (at national, regional and local level) to promote social enterprises in those countries; and 3) synthesizing and presenting good practices in the regulations and promotion of social enterprises in those countries.<sup>1</sup>

### I. 2. Structure of the Report.

In order to achieve the above objectives, the Report is structured in four main chapters, following the Introduction. **Chapter I** includes a **Definition and Key Features of the Development of Social Enterprises** in the countries examined, including a short historical overview of this development, with an eye to presenting why and how the social economy became an important topic for policymakers in those countries. **Chapter II** provides a practical comparative overview of the **Legal Frameworks for Social Enterprises** in the five countries concerned, including the common and country specific analyses of the legal forms in which social enterprises operate; the internal governance rules; the permissibility of direct economic activities; the rules governing profit distribution and the oversight and reporting rules, among others. **Chapter III** goes on to describe and analyze the **EU Policy Framework Relating to Social Enterprises** and its implications at the national level. This include the framework for direct and indirect financial support to SE, the EU rules governing state aid and the procurement; the innovative financing instruments for social enterprises emerging in the countries concerned, the support to SE networking; and other policy measures facilitating the establishment and operation of social enterprises. Finally, **Chapter IV** summarizes the **Key Findings** of the Report in the form of learning points that are meant to serve as a useful guide

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to the legislators and policy-makers seeking to introduce or revise policies impacting on social economy and social enterprises in their countries. The Report lays out an **analytical framework** for the comparative assessment of pertinent laws and regulations and presents **best practices** in nurturing social economy and social enterprises in the examined countries. The Report is also complemented by three **Annexes** that provide summary comparisons of the information pertinent to social economy and social enterprises, which are provided in the Report.

### **I.3. Scope of the Report.**

As the definition of a social enterprise provided in this Report suggests (*infra*, I.4), the concept of a social enterprise is quite complex - and that is even more so when it comes to assessing the legal ramifications thereof. Indeed, any comparison of national legal regimes is a formidable task, which inherently carries a risk of rendering abstract and hence futile judgments. In order to respond to this challenge, an effort is made in the Report to build comparisons on common denominators that are sufficiently loose to integrate less significant variations among the regimes that are examined, but sufficiently specific to produce meaningful comparisons. This is reflected in the structure of the Report in that some of the issues discussed in the Report are addressed generally, whereas some are discussed in a country-specific context, as appropriate.

The Report covers the following countries: Italy, Spain, the United Kingdom, Slovenia and Austria. Italy, Spain, the United Kingdom and Slovenia are chosen because of their advanced legal infrastructure for SE. Italy and Slovenia represent the "open model" of social entrepreneurship, which is primarily concerned with the nature (outcome) of activities (not-for-profit), rather than with institutional forms in which those activities are carried out. In addition, Slovenia is also chosen because of the important similarities with Slovakia in that both represent the successful examples of post-transition countries. U.K. represents the "entrepreneur" model, which envisages a distinct institutional form for a social enterprise. Spain is chosen because it originally represented the "cooperative" model of social entrepreneurship which, as a result of recent legislative changes, is evolving into a more open model. Finally, Austria is chosen because it represents a different model from the other countries concerned in that it does not have a framework regulation for social enterprises, or for that matter a distinct institutional form for social entrepreneurship activities, but rather has chosen to nurture social enterprises and social economy through sets of targeted policy measures.

The Report is developed based on the desk research of pertinent laws, regulations and literature as listed in the Bibliography (see after Annexes).

#### I.4. Social Enterprise: Defining Characteristics.

For the purpose of the Report, the notion of social enterprise (SE) entails organizational forms featuring the following governance, economic and social criteria:

**The governance criteria:** *A degree of autonomy.* SE are voluntarily established, independent, private legal entities. They may heavily depend on public subsidies, when providing services which are otherwise the responsibilities of public authorities, but they are not managed, directly or indirectly, by public authorities. Their owners have the right of both 'voice' and 'exit' i.e. the right to take their own positions and to terminate their activity.

*Decision-making power not based on capital share.* The governance is usually not dependent on the founders/members' stake in the share capital or assets of the organization, in particular in the case of membership organizations (associations, co-operatives), but is rather democratic (one member - one vote). However, there are some notable departures from the principles of democratic governance (e.g. non-membership organizations, such as foundations, limited liability companies, but also membership organizations i.e. social cooperatives with outside investors having the voting rights, *infra*, Chapter II).

*Ownership.* Although SE which operate as membership organizations are collectively owned through co-operative or non-profit structures (i.e. they are part of the third sector or social economy), private companies (joint stock companies, limited liability companies) may also be considered social enterprises, insofar as they are established to pursue social goals, rather than generate profit.

**The economic criteria:** *An economic activity producing goods and/or selling services.* SE are typically not engaged in advocacy, or in distribution of public or private funds. Rather, they are engaged in regular production of goods or service provision.

*A trend towards paid work.* Although SE may engage volunteers in their activities, an organization must have at least one employee to be considered a social enterprise.

**The social criteria:** *An explicit social purpose: to benefit the community or a specific group of people.* The primary purpose of a SE is to pursue social goals (or generate social value), rather than generate profit. They serve the public at large or recognized social groups, rather than individuals.

*Limited distribution of profits.* SE include not only not-for-profit organizations (associations, foundations, private institutions), which are generally obliged by the non-distribution constraints, but also organizations that may distribute some portion of their profits (cooperatives). As a norm, SE re-invest the majority of profit

or surplus to further their main statutory goals. This excludes profit-maximizing organizations.<sup>2</sup>

## **I.5. Development of Social Economy: Key Features in Surveyed Countries.**

### **I.5.1. Italy**

The emergence of social economy in Italy was linked with social movements in 1970s. In the late '80s SE began to consolidate their presence in the general entrepreneurial system, and since '90s the necessary legal infrastructure to support their operations has gradually been put in place (*infra*, Chapter II). SE sought to address failures in the welfare model which was in place in the '70s, which featured limited supply of social services by both public and private sector relative to the other EU countries. The shortages in social services supply were attributed to the relatively low level of economic development, in particular in some regions of the country, the significant role of a family in providing social network support, and the poor efficiency of public administration responsible for the management of social services. Although the budget expenditure of public sector was considerable, the social policy system in place was sluggish and ineffective, in particular with regard to the needs of vulnerable groups: it was distributive in nature, and was primarily concerned with monetary transfers. The growth of the aged population, the declining role of a family as social net provider, which was largely attributed to the increasing presence of women in the labour market, and the emergence of new social needs (e.g. the prevention and treatment of drug abuse, immigration, long-term unemployment, homelessness, etc) further exposed the failures in the system.

At the beginning of '80's SE, in the form of cooperatives or associations, begun to offer variety of services ranging from social assistance to environmental protection, and in the mid of '80s there was approximately 800 operating SE. Social entrepreneurship was driven by private initiative, citizens, young professionals,

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<sup>2</sup>According to EMES, the European research network of individuals and institutions committed to studying social enterprises ([www.emes.org](http://www.emes.org)), the ideal type of a social enterprise entails the following characteristics: a continuous activity producing goods and/or selling services; a high degree of autonomy; a significant level of economic risk; a minimum amount of paid work; an explicit aim to benefit the community; an initiative launched by a group of citizens; a decision-making power not based on capital ownership; a participatory nature, which involves the persons affected by the activity; and limited profit distribution. J. Defourny: "From Third Sector to Social Enterprise", in "The Emergence of Social Enterprise" (edited by C. Borzaga & J. Defourny), 2001, pp. 16–18. On different schools of thoughts with regard to the defining characteristics of social enterprises see also K. A. Janelle: "Social Enterprise in the Unites States and Europe: Understanding and Learning from the Differences", International Society for Third-Sector Research and The Johns Hopkins University, 2006, pp. 247-253, with further references. J. L. Laville, M. Nyssens: "The Social Enterprise: Toward A Theoretical Approach" in "The Emergence of Social Enterprise", op. cit. pp. 312-332.

trade unions, families of disabled persons, using innovative practices in addressing social needs and engaging volunteers in providing SE services.

One of the most prominent examples of SE at the time was the cooperative dealing with social integration of ex-patients of mental hospitals (which were closed in Italy outright in 1978). Following the enactment of the Law on Social Cooperatives in 1991 (*infra*, Chapter II), cooperatives ceased to provide this kind of services.

In 1990 the Government **decentralized** the system of social welfare and transferred the responsibility for delivering social services to **regional** and **local administrations**. It also opened the market of social services and allowed private providers to compete for service provision, thus bringing the welfare system closer to the Anglo- Saxon liberal dual approach, in which the state (local governments included) provides for the most disadvantaged, while not-for-profit organizations (NGOs) and other private actors provide supports to others in need. The subsequent legal reforms in the early 90s and onward, which specifically recognized the concept of public benefit organizations and provided corresponding tax and other benefits; recognized *ex post* a social cooperative pursuing public benefit purposes as a distinct institutional form; and, introduced a general framework regulation for SE, created the necessary legal conditions to further nurture the culture and practice of social entrepreneurship (*infra*, Chapter II). As a result of those reforms, hundreds of operating foundations emerged as social service providers. The **European Social Fund** and its seven-year programming cycles is argued to have been an important factor to the SE development. Thus SE came a long way from providing incidental and new ("marginal") social services to becoming fully integrated into the welfare system, playing a critical part thereof and offering a variety of services. It is noteworthy, however, that the 1990 reform of the welfare system (*supra*), which favored competition over valorization of the most suitable organizational forms to address social needs, presented a new set of challenges for SE. They now face formidable competition of commercial companies as service providers, which might push them into the same (commercial) direction thus losing their distinctive organizational and goal features (*infra*, Chapter II, *social cooperatives*). Nevertheless, it is argued that SE are fit to withstand those challenges and will continue to play an instrumental role in the competitive welfare system, as they are uniquely suited to further social incentives and social capital development, as well as combine social and economic policies, in particular at the local level.

### **I.5.2. Spain**

The development of social economy in Spain in the last decades, following the successful political transition, was attributed to several factors: the Government's commitment to promoting the social economy; the traditional role which cooperatives have played in addressing social needs, which is specifically

recognized in the Constitution, and which requires public authorities to facilitate the development of co-operative enterprises through legislation and encourage workers' access to ownership of the means of production; and, the rapid economic growth which has generated new demands for social services, which the government could not efficiently respond and which led to the development of a viable not-for-profit (third) sector.

Since 1990 the social economy has been expressly acknowledged by public institutions. The beginning of this development was marked with the creation of the National Institute for the Promotion of the Social Economy (INFES), which replaced the former Directorate General for Cooperative Societies and Labor Societies with the Ministry of Labor and Social Security. Among others, the Institute sought to promote SE as innovative model of addressing pressing social needs. The Institute ceased to exist in 1997, and its role was assumed by the Directorate General for the Promotion of Social Economy and the European Social Fund (Directorate), which operates as a separate division of the Ministry of Labor and Social Affairs' Secretariat-General for Employment (*infra*, Chapter III). A number of regional governments have also developed various advisory bodies on issues pertinent to the social economy.

2011 saw significant legislative development, with Parliament enacting the **Law on Social Economy**. The Law provides a general framework for SE to operate, in recognition that a cooperative is no longer suited to be a universal institutional form of choice for social entrepreneurs, but rather the concept has to be open to other institutional forms (*infra*, Chapter II). It also created conditions necessary to support SE operations, as well as activities of their representative bodies with a view of making the social economy more visible and recognized. The Spanish Business Confederation of Social Economy is credited for having played a critical role in bringing this legislative initiative to a successful conclusion (*infra*, Chapter III).

### **I.5.3. Slovenia**

The development of the social entrepreneurship in Slovenia can be traced back in 1960s when first state-owned enterprises employing disabled persons were established – and enjoyed corresponding tax and other social benefits. The regime change in the '90s and the introduction of market economy impacted on the legal forms in which SE operate: the state-owned enterprises gave way to private commercial companies. Very few SE operate as associations, foundations, and private institutions (*infra*, Chapter II).

Most of the Government's social entrepreneurship programs and projects have been focused on the employment of the disabled persons and providing vocational trainings for most vulnerable groups. Those programs nurtured the successful



public-private partnership in tackling the unemployment of those groups.<sup>3</sup> However, there is no available data as to the share of SE tackling the unemployment of vulnerable groups in the overall GDP. In addition, despite the reach tradition of societal activities, the impact of the third sector (NGOs) on the development of social entrepreneurship thus far has been modest at best, which is largely due to its **marginal economic role**. A research carried in 2003 revealed that the third sector employed (full-time or temporarily) only 0.37% of the total number of employees in the country.<sup>4</sup> In 2008 that figure rose to 0,66%, while the third sector share in GDP was 1,92%.<sup>5</sup> The same pertains to cooperatives: there have been only few cooperatives which functionally perform the role of social cooperatives, albeit with very little success. This was primarily attributed to the lack of an enabling legal environment for co-operatives and their mutual character.<sup>6</sup>

One of the overriding reasons cited in the literature for a modest role of social entrepreneurship in Slovenia is the well-functioning system of public institutions, which resulted in fewer gaps that needed to be filled in the system of social service provision by private actors.

2011 saw significant legislative development, the enactment of the **Law on Social Entrepreneurship**, which came into force in 2012. The Law seeks to provide a more enabling legal environment for the development of social entrepreneurship. The impact of the Law on the development of social economy remains yet to be seen, in particular given that its full implementation is contingent on the enactment of a number of implementing regulations (*infra*, Chapter II. ).

#### I.5.4. United Kingdom

.A resurgence of social entrepreneurship in the U.K. begun in the mid 1990s, with various forms of organizations, co-operatives, community benefit societies, charities and community enterprises, coming together by the prospect of using business models to spur social change and address pressing social needs. In 1998 the Labour Government of Tony Blair, following on its election promises, launched the **Compact** on Relations between the Government and the Voluntary and Community Sector, a legally non-binding document which sought to promote a better working relationship between the government and the third sector. Along with the Compact there were five codes of good practices, including the Code of Practice on Funding and Procurement. Those documents were agreed by both parties and released in

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<sup>3</sup> .Giacinto Tommassini *at all*, *Social Economy in Montenegro* (in Monenegrin), Podgorica, 2006, pp. 84-86

<sup>4</sup> Ibid. p. 6.

<sup>5</sup> [www. socialinnovationeurope.eu/node/1924](http://www.socialinnovationeurope.eu/node/1924)

<sup>6</sup> *Studies on Practices and Policies of the Social Enterprise Sector in Europe*. Country Fiche: Slovenia, p. 5. Giacinto Tommassini *at all*, *op. cit.* p. 85.

2000. In response to the so called Deakin report,<sup>7</sup> the Local Government Association developed the Code of Conduct on Engagement between Local Authorities and the Third Sector. As a result, voluntary (not-for-profit) organisations have been increasingly involved in a range of initiatives with local authorities, such as local strategic partnerships, crime and disorder partnerships, and developing children's trusts.

In 2001 the Department of Trade and Industry (now the Department for Business, Innovation and Skills - BIS) established the **Social Enterprise Unit** (SEU) with a mandate to co-ordinate stakeholders of the social enterprise sector and government officials, identify the main challenges facing SE, and make recommendations for improving the environment for starting and sustaining such enterprises. The creation of the SEU was widely perceived as a groundbreaking development in this respect. Between 2001 and 2006, SEU led a range of positive developments with regard to the policy, legislation and funding/financing regimes which provided critical support to the emerging social economy. It is credited for the Government's definition of a SE (*infra*), which was set out in the 2002 policy paper *Social Enterprise: A Strategy for Success*, aimed at promoting the social enterprise sector and built momentum across government, the third sector and funders. The SEU also spearheaded efforts to introduce a distinct institutional form for social enterprises: the community interest company (*infra*). In 2006 the SEU was replaced by the **Office of the Third Sector** in the Cabinet Office and in 2010, following general elections, the Office of the Third Sector was renamed to the **Office of Civil Society** (*infra*, Chapter III).

### I.5.5. Austria

The development of social economy in Austria was historically shaped by several factors: the traditional influence of the Catholic Church and its network of charity (public benefit) organizations promoting social welfare and the principle of subsidiarity; the emergence of charity organizations affiliated to the socialist (and latter on social-democratic) political movement which favored consumer co-operatives, rather than producer co-operatives; and, the corporatist organization of the state (*Sozialpartnerschaft*), which encouraged a closer partnership between the state and "social partners" (not-for-profit organizations and other private actors). Since '80s the Government's measures towards the promotion of social economy have primarily focused on achieving two goals: **providing social integration**

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<sup>7</sup> In 1995 an independent commission on the future of the third sector was set up by the *National Council for Voluntary Organisations* (NCVO). The commission was chaired by Professor Nicholas Deakin and sought to offer a ten year vision of the role of the third sector in England. The "Deakin Report", published in 1996, provided 61 recommendations as to how to improve the relationship between the Government and the third sector

through training and employment of vulnerable groups as defined by law; and, **providing social services by NGOs** embracing market oriented approach.

As for social service provision, public benefit organizations (PBOs), in particular those affiliated with churches and political parties, have traditionally played a prominent role in the social welfare system. Information pertinent to social service provision is difficult to verify though, given that most of activities related to social service provision are not subject to the reporting by the Federal Statistics Agency. Nevertheless, available data indicate that PBOs engaged in social service provision (social service organizations) constitute 14% of the overall number of NGOs; employ 53% of all employees in the third (non-profit) sector (approximately 100.000 altogether); and, contribute about a third of total value added taxes paid by NGOs. A survey carried in 2002 indicated that 98% of social service organizations received public funds, predominantly in the form of contract fees and grants.

## II. LEGAL FRAMEWORK FOR THE ESTABLISHMENT AND OPERATIONS OF SE.

### II.1. Legal forms for SE common to the countries concerned.

As discussed in this Chapter, SE operate in multitude of legal forms; this also pertains to the U.K., despite its distinct institutional form for SE, the community interest company (*infra*). SE may operate, *inter alia* in the form of associations and foundations. Because the legal framework for those forms are harmonized a great deal among the countries concerned, save for the U.K., those forms are discussed below in general terms, rather than in the proceeding country-specific sections. Only rules pertinent to **public benefit associations and foundations** will be discussed, as they are relevant for the concept of SE. The legal framework for foundations in Austria will not be discussed, because they are not relevant to the concept of SE in that country.<sup>8</sup> As already noted, the U.K. is left out from the proceeding sections 1.2. and 1.3., because its concept of an "unincorporated association" (i.e. that without the legal entity status) is not suited for SE (*infra*, 2.4.1.). In addition, it does not recognize foundation as a distinct institutional form.

#### II.1.2. Associations.

Definition. An association is a voluntary membership organization which may pursue any legitimate mutual or public benefit goal. Both legal and natural persons may be the founders of an association.<sup>9</sup> While registration (i.e. obtaining the legal entity status) is voluntarily, it is essential for an association to acquire the public benefit status, or register as a SE (*infra*, Italy, Spain, Slovenia).

Founding Capital. No founding capital is required to establish an association. Italy stands out as an exception in this respect: the law requires that an association seeking the legal entity status must have asset deemed sufficient to accomplish its goals. The minimum assets threshold is not prescribed, but rather this issue is left at the discretion of the registration authority.

Governance. An association must be **democratically** governed.<sup>10</sup> The highest body of an association is the general assembly composed of all members. The law in the countries concerned does not provide for mandatory participation of employees or beneficiaries in the management of the organization.

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<sup>8</sup> In Austria, social enterprises operate in the form of association and not-for-profit corporation.

<sup>9</sup> The law requires at least two founders to establish an association in Italy and Austria; and at least three founders in Spain and Slovenia.

<sup>10</sup> This is mandated *inter alia* by the European Convention on Human Rights; if an association were to enjoy protection afforded by Article 11 of the Convention (freedom of peaceful assembly and association), it must be *democratically* governed.

*Income.* An association may generate income from gifts, donations, public funds, fund-raising activities, economic activities, and other legitimate sources.

*Economic Activities.* All the countries concerned allow an association to engage in economic activities, provided that income generated from those activities is re-invested to further the major goal of the organization. In some countries (Italy, Slovenia) an association may engage only in related economic activities i.e. those deemed necessary to support its main statutory goals. In Italy, those activities must not amount to the organization's primary activities.<sup>11</sup> The prevailing view of both the scholars and the jurisprudence is that the breach of the economic activity rules does not necessarily alter the not-for-profit nature of an association, but rather triggers the application of certain rules governing commercial companies (e.g. the drawing up of the balance sheet, the bankruptcy proceedings, etc). The Law on Public Benefit Organizations sets out additional conditions for not-for-profit entities (associations and foundations) to engage directly in economic activities, as well as provides rules governing the distribution of their assets (*infra*). In Slovenia economic activities are allowed to the extent necessary for the organization to accomplish its major statutory goal, but the law does not provide further guidance in this respect.

In Spain an association may engage in both related and unrelated activities, insofar they do not give rise to the issue of distorted competition. Austria distinguishes three types of economic activities in which an association may engage: a) related economic activities; 2) the so called dispensable economic activities i.e. those which are not deemed necessary to accomplish the statutory goals of the organization, but are nevertheless related to those goals (e.g. selling donated goods at a discount price); and 3) unrelated economic activities, which are subject to taxation e.g. share in partnership, or organizing lottery (*infra*, Chapter III).

*Distribution of Income and Assets.* No portion of the association's income or asset, including that generated from economic activities, may be distributed among the founders, members of the governing bodies and persons affiliated thereof (the non-distribution rule).

*Transformation.* An association may merge with another association pursuing the same or similar statutory goals, if so envisaged by the statute of the organization.

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<sup>11</sup> According to the Ministry of Finance, an economic activity is understood to be an activity which produces a "business income", pursuant to Article 55, Paragraph 2, of the Decree of the President of the Republic 917/86, including the supply of services, and for an amount which exceeds the direct attributable costs. Some activities, such as providing educational services, are deemed *per se* economic activities, regardless of the nature of a service provider (for or not-for-profit legal entity).

*Distribution of Remaining Property.* The remaining property of an association may only be transferred to another organization or public institution pursuing the same or similar (public benefit) goals, as envisaged by the statute and following a decision of the competent body. Austria stands out as an exception in this respect: in case of voluntary dissolution, a limited distribution of asset among members is allowed, if so envisaged by the statute and provided the value of received assets does not exceed the value of their contributions to the association.

### II.1.3. Foundations.

*Definition.* A foundation is a non-membership organization with assets designated to pursue any legitimate not-for-profit goals. Depending on a country, those goals may be for public benefit (Spain, Slovenia) or for public and mutual benefit (Italy). A foundation may be established by a solo founder (legal or natural person).

*Founding Capital.* The initial capital (endowment) is necessary to establish a foundation. The law in the countries concerned does not prescribe the minimum endowment threshold, but the registration practice suggests that a foundation must have an endowment of at least 100,000 Euro in Italy and 30,000 Euro in Spain, in order to be entered into the registry.

*Governance.* A foundation is a pool of property (*universitas rerum*), rather than a membership organization, which has implications on its governing structure: it does not have a general assembly as the highest governing body (because it does not have members), and therefore is **not governed by democratic principles**. The highest body of a foundation is the board of trustees, which manages the organization and represents it towards third parties. Likewise an association, the law does not provide for mandatory participation of employees or beneficiaries in the management of the foundation.

*Income.* The same rules governing sources of income of an association apply accordingly to foundations, (*supra*).

*Economic Activities.* In Italy and Spain foundations may engage in economic activities under the same conditions prescribed for the (public benefit) associations. In Slovenia, rules favor foundations over associations in that the former may also engage in unrelated economic activities.

*Distribution of Income and Assets.* The non-distribution rules governing associations apply accordingly to foundations.

Transformation. A foundation may merge with another foundation pursuing the same or similar statutory goals, if so provided by the statute and if consistent with the will of the founder.

Distribution of Remaining Property. The remaining property of a foundation may only be transferred to another foundation or public institution pursuing the same or similar (public benefit) goals.

## II.2. Country-Specific Legal Framework for SE.

### II.2. 1. Italy

#### II.2.1.1. Introduction.

Organizations recognized as "social enterprises" are governed by the complex web of legislation. Some of it is said to be outdated (e.g. the Civil Code), some of it has introduced a mix of for-profit and not-for-profit principles which still need to be fully reconciled (e.g. the Law on Social Cooperatives, the Law on Social Enterprises, *infra*), and some of it overlap to some extent (e.g. the framework regulation for NGOs, the Law on Public Benefit Organizations, and the Law on Social Enterprises, *infra*). Nevertheless, it is widely recognized that associations, foundations (already discussed *supra* in 1.2. and 1.3.), and social cooperatives are the most prominent institutional tools of choice for SE.<sup>12</sup>

#### II.2.1.2. Social Co-operatives.

Definition and Governing Rules. In 1991 Italy introduced a special form of cooperative: a social cooperative. Unlike the traditional types of cooperatives, which may only be established to pursue mutual benefit goals (i.e. goals which serve the interests of their members), a social cooperative may be established to pursue activities in the "**general interest of the community and for social integration of citizens**". The Civil Code (CC) rules governing cooperatives also apply to social cooperatives, insofar as they are compatible with the Law on Social Cooperatives (Law). In the absence of specific rules in the CC and the Law, the rules governing joint stock companies and - in the case of small cooperatives (those having up to eight members) - governing limited liability companies apply, insofar as they are compatible with the Law. The applicable rules recognize the **hybrid nature** of

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<sup>12</sup>In addition, joint stock companies and limited liability companies may also operate as social enterprises, provided certain conditions are met (*infra*, the Law on Social Enterprises). Finally, the agreement between the Holy Chair and Italy sets out special (privileged) regime for charities established by the Catholic Church, the status of which fall out of the scope of the Report.

cooperatives, including the social ones: a cross between for-profit and not-for-profit organization,<sup>13</sup> but also espouse the universal principles of co-operative organization: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education; training and information; co-operation among co-operatives; and, concern for community.<sup>14</sup>

*Types.* The Law envisages two types of social cooperatives: cooperatives **type "A"**, which provide social, health, and educational services; and, cooperatives **type "B"**, which produce goods and services i.e. engage in any type of economic activities - other than providing social, health and educational services - which further the **work integration** of the disadvantaged groups, as defined by law. Approximately 80% of social cooperatives operate as type "A" co-ops. While co-ops type "A" essentially operate as commercially-driven enterprises, co-ops type "B" perform somewhat different role: they are work integration or sheltered employment organizations. At least 30% of the workers in co-ops "B" (members and non-members) must be the disadvantaged. Those groups benefiting from the co-ops type "B" include: persons with physical or learning disabilities; persons with visual difficulties; persons released from psychiatric institutions or otherwise treated for mental illness; drug and alcohol addicts; and, persons who have been given an alternative to custodial sentences. They are featured with limited member growth (between 15 and 100), in order for members to keep close family ties. In practice, it is common that workers are members of co-ops type "B". It is argued, however, that many co-ops which essentially belong to type "B" are discriminated in that they are not recognized by law to meet the 30% threshold (and enjoy the corresponding benefits, *infra* Chapter III), as they seek to integrate the social groups which are not explicitly recognized by law as disadvantaged groups, such as the homeless, long-term unemployed, single parents, and refugees.

*Founders.* At least three legal or natural persons are required to establish social (or for that matter any other) cooperative. As for the natural persons, founders and members of a social cooperative may include employees, managers, paid volunteers, beneficiaries of its services, such as members of the recognized disadvantaged groups, and unpaid volunteers. However, they must not account for more than 50% of the total workforce. Both private and public legal persons may be founders/members of a social cooperative. In practice, many social cooperatives, in particular type "A", are co-founded by municipalities. The statute of social co-

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<sup>13</sup> A cooperative which has less than twenty members and assets not exceeding 1 million € has a discretion to choose whether it will be governed by the (supplementary) rules of the joint stock company or limited liability company.

<sup>14</sup> Roger Spear: From Co-operatives Towards Social Enterprises: Trends in European Experience, in Trends and Challenges for Cooperatives and Social Enterprises in Developed and Transition Countries (edited by Carlo Borzaga, Roger Spear), Trento, 2004, p. 105.



operative, rather than law, is the controlling instrument on issues relating to the admission of new members and termination of membership.

*Founding Capital.* The Law does not provide the minimum amount of share capital necessary to establish a social cooperative - or for that matter the minimum contribution of a member to the share capital of the organization. Rather, those issues are left at the discretion of founders/members. The absence of mandatory rules with regard to the share capital means that it does not serve the functions which are traditionally ascribed to the share capital of a joint stock or limited liability company: it is not the instrument of the creditors' protection, nor does it principally affect the voting power of members of a cooperative.

The founding capital of a social cooperative is divided into shares, with a value of at least 25 € up to 500 €. Shares may not be transferred to another person without the authorization of the management body. The statute may prohibit the transfer of shares, but in such instances members are nevertheless entitled to withdraw from organization after two years following the date of their admission. Each member may not hold more than 100.000 € of shares. This rule does not apply to members which are legal entities and financial members (*infra*).

*Governance.* A social cooperative must have the general meeting, the board of directors and the supervisory body, or an external auditor. The 2003 reform have eased the requirements with regard to the governance of cooperatives in that it scraped the rule mandating that only members of a cooperative may seat on the board of directors and introduced the majority rule instead. The general assembly is the highest body of a cooperative. Every member has one vote in the general assembly, regardless of his contribution to the fixed capital, in concurrence with the principle of democratic governance. There are few notable departures from this principle, though. Firstly, the statute of the organization may assign to a member which is a legal entity (another cooperative or other form of a legal entity) multiply votes, with a maximum of five. The multiple voting rights may be determined in relation with the legal entity's share in the cooperative's share capital, or in relation to the number of its members. Secondly, the statute may determine votes in proportion to the transactions between a member and a cooperative in question. However, this exception is possible only in cooperatives whose members are "entrepreneurs", regardless of whether they are (commercial) legal entities or natural persons. Finally, the statute may determine voting rights in the election of the supervisory board in proportion either to a member's participation in the share capital, or participation in mutual transactions between members and a cooperative in question. Because of the peculiar features of social cooperatives (public benefit, rather than mutual benefit organizations), the second and the third exception of the democratic governance rule has limited significance.

*Participation.* The rationale behind cooperatives type "B" is participation by service users where it is possible, or if not, by user's families (e.g. parents of severely disabled persons). The type 'B' cooperative is argued to enable the transformation of passive service consumers to active participants in the governance of the service-provider, thus promoting participatory democracy.

*Distribution of Profits.* A social cooperative must allocate at least 30% of the annual total profits to the compulsory reserve fund, regardless of the amount of legal reserves. The compulsory contribution rules offset limited relevance of the share capital in a cooperative. It also reinforces the non-distribution constraints and the solidarity aspect thereof. In addition, a social cooperative must allocate 3% of annual profits to the mutual funds which are managed by co-operative umbrella organizations, and which serve to promote and nurture co-operative developments, including the establishment of new cooperatives. As for the allocation of the remaining profits, there is a distinction between the mutual benefit and the social cooperatives in that the latter are only obliged to stipulate in their statutes the maximum percentage of profits which may be distributed to their members.<sup>15</sup> However, distributed profits are restricted to 80% of total profits, and profit per share must not be higher than 2% of the rate of that available on bonds issued by the Italian Post Office.

*Raising Capital.* The 2003 reform of the Law on Cooperatives sought to boost the financial sustainability of cooperatives by placing them on equal footing with limited liability companies concerning the financial instruments they may issue to increase their liquidity and capital base. Thus, a social cooperative may issue: the equity-financial instruments (and therefore admit investor-members); the debt-financial instruments (e.g., bonds); and, hybrids (e.g. participative bonds - that is, bonds related to the performance of a cooperative or shares which guarantee the fixed minimum return, regardless of the performance of a cooperative, but not the voting rights). Significantly, investors (financial members) can hold up to 33% of voting rights, and 49% of seats on the board, which **challenges the traditional notion of democratic member control** as one of the distinctive features of co-operatives. These rules are seen as part of a growing trend to facilitate the operations of cooperatives in more competitive capital and product markets (e.g. Sweden, Spain, and France), however, they also pose the risk of **blurring** a distinction between **cooperatives** and business **enterprises**.<sup>16</sup>

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<sup>15</sup> There is a distinction in the Italian law governing cooperatives between profits and refunds. Dividends are paid from net profits, based on a member's share in the fixed capital. Refunds is additional remuneration to members of certain portion of the price paid for buying goods and services from the cooperative, or is additional remuneration of members for their work execution or contribution to the provision of goods and services rendered by the cooperatives. The law does not prescribe any minimum or maximum threshold with regard to the distribution of profit or refunds.

<sup>16</sup> This trend is in particular reflected in adaptations of legal forms in which cooperatives operate by allowing the issuing of non-voting shares to outside investors; expanding the membership base to include

*Transformation.* Unlike a mutual cooperative, a social cooperative may be transformed into any form of company, however, the applicable rules are not conducive to such transformation. In the event of transformation, a social cooperative must devolve its remaining assets to mutual funds, after deducting the paid-up capital, and if needed, must contribute the additional amount necessary to meet the minimum share capital threshold requirement prescribed for the type of a company into which it is being transformed.

*Distribution of Remaining Property.* No asset can be distributed to members in case of dissolution, which effectively prevents "mutualization" of an organization. The non-distribution rule applies irrespective of whether the organization has obtained the public benefit status.

Because of the critical role of the social cooperatives in the overall concept of SE in Italy, its economic significance (*infra*, Annex I), as well as the fact that number of countries are contemplating introducing a similar form (e.g. Serbia, Montenegro), bellow is presented a swot analyses of the social cooperatives.

#### SOCIAL COOPERATIVES: SWOT ANALYSIS<sup>17</sup>

STRENGTHS:	WEAKNESSES:
Small enterprises deeply rooted in local communities understanding their needs, and better suited to swiftly respond to pressing social needs than public institutions;	Rapid growth which is not supported with proper institutional development and increase of competent management base;
Introducing innovative models and practices in addressing social needs; .	Increasing dependence on public authorities in articulating their goals and activities;
Ability to form platforms, mobilize stakeholders, and effectively advocate for their interests;	Lack of volunteers to support the rapid growth;
Ability to attract and mobilize volunteers;	Lack of proper accreditation for SE (including those which operate as social cooperatives) to monitor the

financial partners and employees; and introducing voting rights away from the principle of equality of members towards voting rights based on the share capital. In addition, there is a growing trend of separating social and economic aspects of cooperative at the expense of the former. See Spear, p. 106 and further.

<sup>17</sup> Developed by Dragan Golubović.

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<p>High degree of independence from public authorities in articulating their policies and pursuing activities;</p> <p>On equal footing with commercial companies with regard to raising the capital.</p> <p>No limits to engage in economic activities and still qualify for tax benefits afforded to public benefit organizations (social cooperatives, included, <i>infra</i> 2. 1. 3.)</p>	<p>quality of their work.</p>
<p><b>OPPORTUNITIES:</b></p>	<p><b>THREATS:</b></p>
<p>Local authorities have favorable attitude and appreciate their ability to introduce new and innovative services;</p> <p>Private donors (corporations and individuals) enjoy tax benefits for giving to public benefit organizations (social cooperatives included), which can be an increasingly important source of income;</p> <p>Considerable interest of politics (at the EU and national level) for social enterprises.</p>	<p>Increasing dependence on public financing and public authorities impacts adversely on their institutional independence and financial sustainability;</p> <p>Opening social market for commercial companies increases pressure on the social cooperatives to be commercially driven, thus losing their distinctive futures and democratic character.</p> <p>Increasing pressure by private competitors and courts to scrap tax benefits for the social cooperatives, as they allegedly distort competition.</p>

**II.2.1.3. Public Benefit Organizations.**

*Institutional forms and scope of activities.* For the institutional framework in which SE operate in Italy two additional legal instruments bear particular relevance: the Legislative Decree No. 460/1997 on the Legal Status of Public Benefit Organizations (PBO Law), and the 2005 Law on Social Enterprises, along with the 2006 Legislative Decree on the Implementation of the Law on Social Enterprises (*infra*). As for the former, it is important to note that a public benefit organization (PBO) is not a

distinct institutional form *per se*. Any **not-for-profit** legal entity (associations, foundations), as well as a **social cooperative**, may apply for the **public benefit status**, if its main statutory goal falls under any of the following categories: social and health assistance, health care, charity, education, training, amateur sport, protection and promotion of historical buildings or handicrafts, protection and improvement of the environment, culture and art promotion, civil rights' protection, and scientific research of public interest carried out by foundations or universities. In addition, in order for an organization to apply for the public benefit status, its activities must be for the benefit of the disadvantaged population (i.e. improvement of their physical, mental, social, or economic conditions) or, in case of international humanitarian assistance, for the benefit of foreign nationals. Some activities – such as the promotion and protection of the environment and historical heritage – are deemed *per se* public benefit activities.

*Granting PBO status.* An organization which is granted a public benefit status is entered into the Registry of Public Benefit Organizations, which is run by the Ministry of Finance. This is in recognition of the fact that the primary purpose for an organization to seek the public benefit status are tax benefits afforded thereto. An organization may engage in activities deemed for public benefit without being entered into the Registry of PBOs, however, in such case it will not qualify for tax benefits (*infra*, Chapter III). The public benefit concept thus responds to unsatisfied social demands and permits PBOs to take on responsibilities which are otherwise the prerogatives of the Government (the subsidiarity principle).

*Restrictions on PBOs.* In consideration for the tax benefits afforded, the Law imposes a number of restrictions on PBOs, to ensure their greater transparency and preserve their not-for-profit character: 1) A PBO may not be established to pursue not-for-profit goals deemed "political" (i.e. advocating or fundraising for a political party or candidate); 2) A PBO must invest all income in its statutory activities, and may not distribute it among its members or affiliated third parties, directly or indirectly. Sales to donors at a discounted price, as well as purchases by donors of a PBO's goods and services at a price exceeding the market price, wages to employees exceeding 20% of the average wages, and remunerations of the board members exceeding the thresholds provided by law for remunerations of members of the supervisory board of a joint stock company are all considered to be distributions of profit. However, a **social cooperative** with the public benefit status may still engage in the (limited) distribution of profits (*supra*, 2.1.2.); 3) A PBO may directly engage in related economic activities insofar as they do not amount to the primary (prevailing) activities of the organization. However, this restriction applies to associations and foundations, and not to **social cooperatives**: they can engage in economic activities without any particular restrictions and still qualify for tax benefits; 4) associations and foundations with the public benefit status may not hold the majority shareholding in a joint-stock company which is not engaged in any of

the foregoing qualifying (public benefit) activities. It is not quite clear how the recent European Court of Justice's decision, which ruled that a foundation cannot be considered a commercial entity just because it holds a majority shareholding in a company, unless it directly manages it and interferes in the affairs of its management board, will impact on the current shareholding restrictions in the Italian PBO Law; 5) in case of dissolution, a PBO must designate the remaining assets to another PBO pursuing the same or similar statutory goals; 6) PBOs are subject to more stringent supervision and reporting rules than organizations without the public benefit status. In case of the breach of the foregoing rules, an organization may ultimately lose its public benefit status and the corresponding tax benefits.

#### **II.2.1.4. The Law on Social Enterprises.**

*Definition.* The Law No. 118/2005 and the Legislative Decree No. 155/2006 provide a general framework for SE (*impresa sociale*). Similar to the concept of public benefit organizations, the notion "social enterprise" does not refer to a distinct institutional form. Rather, any organization which fulfils the following criteria is deemed a SE: 1) it is a private legal person (associations, foundations, social cooperatives, but also commercial companies), which is established and granted the legal entity status according to the conditions laid down in the framework regulation (the Civil Code, the Law on Social Cooperatives, laws governing commercial companies). This all-encompassing (open) approach reflects the underlying goal of the Law: to give the legal clarity to the concept which was hotly debated among scholars, practitioners, and policy makers, and to promote and nurture pluralism and voluntary initiatives in the area of social service provision, as well as in other areas identified in the Law; 2) it engages in regular production and exchange of goods and services having "social utility" and seeking to achieve public benefit purpose, rather than generate profit. An organization is considered a SE if it generates at least 70% of its income from entrepreneurial activities (i.e. production and exchange of goods and services having social utility); 3) it does not distribute profit, directly or indirectly, but rather invests it to further its main statutory (not-for-profit) goal, or to increase its assets. Remuneration of members of the management board which exceeds 20% of the average remuneration of the management board of commercial companies operating in the same or similar field is considered an indirect distribution of profits. The non-distribution constraints do not pertain to social cooperatives, which are allowed limited profit distribution (*supra*, 2.1.3.).

The "entrepreneurial" aspect of SE merits further consideration. Consistent with the Civil Code's definition of an enterprise, a SE must engage in the production of goods or social service provision in organized, steady, and professional fashion. Accordingly, **NGOs** whose primary purpose is grant distribution, or administration of its own asset **do not qualify** as SE (e.g. grant-making foundations); the same

applies to **NGOs** providing social and other services **free-of-charge**, or at reduced prices. Thus the Law divides NGOs (the third sector) into two categories: the "firms", engaging in entrepreneurial activities for social purposes (which are the subject of the Law), and other NGOs which do not operate as "firms". It is argued that this distinction will facilitate the contracting out of services by local municipalities and state authorities in that it provides a clear set of criteria necessary for an NGO to be a service provider (i.e. it must be a "firm"). This approach is also reflected in the fact that while SE may engage volunteers, they may not exceed 50% of its total work force.

*Scope of Activities.* The Legislative Decree specifies activities in which a SE may engage. These include: social welfare; health; education; instruction and professional training; environmental and eco-system protection; development of cultural heritage; social tourism; academic and postgraduate education, research and delivery of cultural services; extra-curricula training; and, support services to SE supplied by entities which are at least 70% in the ownership of SE. In addition, an organization is deemed a SE if it operates in the fields other than those stipulated in the Decree, provided that its main statutory purpose is work integration/sheltered employment of disadvantaged people, in which case at least 30% of its employees must be underprivileged or disabled persons, as defined by Article 2. Para 1., of the European Commission Regulation No. 2204/2002 on the Application of Article 87/88 of the EC Treaty Regarding the State Aid to Employment. The relative condition of each worker must be certified according to the legislation in force.

*Registration.* The article of incorporation must specify the filed of activity and the not-for-profit goal a SE purports to serve. A SE is entered into the Registry of Commercial Companies and must have a prefix: "social enterprise" in its name. Sanctions are not provided, however, for the breach of this obligation.<sup>18</sup> The foregoing rules presumably apply to public benefit organizations which are entered into the PBO Registry with the Ministry of Finance, and which want to continue to operate as SE, as well as to social cooperatives without the public benefit status. Rules governing the groups of companies (including minority protection) apply to the group of SE accordingly.

*Governance.* Consistent with the all-encompassing institutional approach, a SE **does not need** to be governed by **democratic principles**; its governance will ultimately depend on the choice of institutional form (an association, a foundation, a social cooperative, or a company). Regardless of the institutional form, however, **workers and customers** must be **involved** in a SE **decision-making** process. This obligation

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<sup>18</sup> Social cooperatives which already operated at the time the Decree was enacted were given a period of one year to change their prefix into "social enterprise". However, the lack of the prescribed sanctions renders this provision optional, rather than mandatory.

is broadly construed so as to include any information sharing, consultation or participation process through which the workers and customers can at least have a say on issues relating to the working conditions and quality of goods and services which a SE provides. It is arguable to what extent these decision-making rules can be legally enforced, but in any event a SE is obliged to detail the consultation processes in its "social balance sheet" (*infra*, Chapter III).

*Tax and Other Benefits.* The Law specifically stipulates that **no** additional **burden** for **public finances** should result from its enforcement. Accordingly, it **does not** provide for any tax or other benefits. Rather, the rules governing the tax status of PBOs apply to SEs accordingly.

*Dissolution.* The dissolution, merger and transformation of a SE must be executed in a fashion which is consistent with its social goals and not-for-profit character, as provided in the Decree.

It is noteworthy that the full implementation of the framework regulation for Se is dependent on a number of decrees that are yet to be drafted, including the one detailing constraints with regard to the ownership and the control structure. Nevertheless, the concept of SE seems to have already given rise to a number of issue that need to be sorted out. In particular:

- It is not clear what are presently the underlying benefits for a public benefit organization to operate as a "social enterprise", given that the latter is not afforded any additional tax or other financial benefits? On the other hand, the SE status triggers additional obligations, including the workers participation in a decision-making process, as well as transactional costs associated with the amendments of the status and entering into the SE Registry, as well as additional reporting requirements.
- The list of activities in the PBO Law, for which tax benefits are provided, does not fully mirror the list provided in the Law on Social Enterprises in that the latter entails some activities (e.g. support for social enterprises), which are not addressed in the former. The **tax ramifications** of this discrepancy remain to be seen.

**As of March 2010, only 601 social enterprises are entered into the SE Registry.**



## II.2. 2. Spain

### II.2.2.1. Introduction.

The 2011 Law on Social Economy provides a general framework for "social economy organizations"/SE, which specifically include: associations, foundations, cooperatives, and mutual associations which carry out economic activities, as well as organization which are created by virtue of specific legislation, such as labor associations, sheltered employment centers, and work integration centers. In addition, mostly as a result of historical circumstances, some specific forms of organizations, such as agricultural societies in transformation, and fishermen societies, are also listed as SE. Finally, the Ministry of Labor and Immigration, at the advice of the Council for the Promotion of Social Economy, may grant the status of a SE to other institutional forms, which are not specifically referenced in the Law.

### II.2.2 2. Social Initiative Cooperatives.

*Jurisdiction.* The legal framework for cooperatives is addressed at the state-level Law on Cooperatives (No. 27/1999), as well as at the level of autonomous regions. The former pertains to cooperatives which operate on the territory of two or more autonomous regions, none of which qualifies as a predominant region of their activities, while the latter pertains to cooperatives which primarily operate on the territory of one autonomous region. Fourteen regions have enacted their respective laws on cooperatives thus far. In addition, various types of cooperatives are governed with specific regulation (e.g. household cooperatives, consumer cooperatives, insurance and credit cooperatives).

*Definition.* The Law defines a cooperative as a voluntary organization which carries out any permissible economic activity in other to further economic and social interests and aspirations of its members, and which is democratically governed, pursuant to the principles espoused by the *International Cooperative Alliance*. The only notable exception of the mutuality of the cooperative goals is the **social initiative cooperative** (*Cooperativas de Iniciativa Social - CIS*), which - similar to the Italian social cooperative - provides services of general interest in the field of education, welfare and medical fields (type "A") or engage in work integration of socially excluded persons (type "B"). It is within the jurisdiction of the respective regions to provide a more detailed regulation on CIS, including the scope of their economic activities, if they choose so. SIC is deemed **not-for-profit** entities and distribution of profit is allowed only through the attribution of dividends at a legal rate. The board membership is on a voluntary basis and employed members'/hired workers' remuneration must not be higher than a predefined percentage of the figure established by collective bargaining.

*Founders.* Public bodies may also be the founders/members of CIS, if so provided by its statute. The statute may envisage voluntary members, which can participate to the board meeting, but without voting rights. This is said to bring a higher level of democracy to the decision-making process of a SE.

*Governance.* Consistent with its general features, a social initiative cooperative must be democratically governed, with the general meeting of all members being the highest body of the organization. As a general rule, members have equal voting rights, irrespective of their contribution to the share capital.

*Raising Capital.* Like other cooperatives, CIS may issue equity (shares with voting rights) and debt financial instruments (fixed dividends) to attract capital investments, however, the outside investors (equity owners) may not have more than 35-45% of the voting rights, depending on the region. Similar to Italy, extending voting rights to outside investors poses a challenge for the democratic governance as one of the distinctive features of co-operatives, as well as for its hybrid nature.

### **II.2.2.3. Labor Insertion Companies.**

A labor insertion company is not a distinct institutional form which is legislated at the state level. Rather, insofar as they are regulated at the regional level, they operate as commercial (for-profit) companies or social initiative (not-for-profit) cooperatives. In the case of the former, they may be subject to some limits in profit and assets distribution.

### **II.2.2.4. Public Benefit Organizations.**

*Public Benefit Criteria.* The Law on Taxation of Not-for-Profit Legal Entities (No. 49/2002) is the controlling instrument for PBOs, which reflects that fact that the legislator regards it primarily a **tax issue**. The Law does not provide for a list of activities/goals deemed for public benefit. Rather, it draws on the NGO framework regulation (i.e. the Law on Associations and the Law on Foundations) in this respect. The Law on Associations specifically references **support to and research on social economy** as one of the activities deemed for public benefit. The case law on the subject is yet to be developed. Associations, foundations and their respective umbrella organizations, but apparently not social initiative cooperatives, may apply for the public benefit status, provided they meet the following criteria: 1) they are already entered into the Registry of Associations and the Registry of Foundations, respectively 2) they seek to accomplish goals deemed for public benefit, as defined by law; 3) they must invest at least 70% of their annual revenue in their main statutory activities. The organization is deemed to meet these criteria if the revenue is spent in the course of four years following the financial year in which the revenue

is reported. The rest of a foundation's revenue must be used to increase its endowment or reserves; 4) they serve certain social groups or public at large, rather than their founders, members, members/trustees of the board, members of other governing and supervisory bodies, or persons affiliated with them as defined by the Law. Activities seeking to support workers of one or several companies and their relatives are deemed to satisfy this criteria; 5) members/trustees of the management board must perform their duties free-of-charge;<sup>19</sup> 6) they have sufficient personnel, resources and adequate organizational structure to accomplish their public benefit goals. 7) in the case of dissolution, their remaining assets must be designated to another foundation or association pursuing the same or similar statutory goal, or to a public institution, if so provided by the statute of the organization. If the statute is silent on that issue, the supervising authority will decide on the distribution of the remaining assets.

*Granting the Status.* The application for a public benefit status is filed with the Tax Administration Office, which renders the decision to that effect. The Office reviews the compliance of the application with the prescribed conditions every year. In case of the breach of the foregoing rules, an organization may ultimately lose its public benefit status and the corresponding benefits. Similar to Italy, an association and a foundation may engage in activities deemed for public benefit without being granted the public benefit status; a PBO status is necessary only for an organization to enjoy the corresponding tax and other benefits (*infra*, Chapter III).<sup>20</sup>

#### **II.2.2.5. The Law on Social Economy.**

*Goal and Definition.* As already noted, in 2011 Spain enacted the Law on Social Economy (No. 5/2011). Similar to the approach embraced by Italy, the Law does not envisage a SE as distinct institutional form, nor does it supplant the general framework regulation governing the establishment, internal governance and dissolution of various institutional forms in which SE operate (*supra*). Rather, it sets out principles which an organization must observe in order to be deemed a SE. For the purpose of the Law, social economy is deemed an economic activity carried out by an organization which observes the following guiding principles: 1) primacy of mutual or public benefit (social) statutory goals over generating profits; 2) democratic, transparent and participatory governance; 3) benefits generated from the organization's economic activity principally distributed based on the work performed and services rendered by their members, or based on the public benefit (social) goal of the organization, where appropriate; 4) independence from public authorities (i.e. voluntary, private legal entities); 5) commitment to internal and external solidarity, local development, social cohesion, inclusion, and sustainability.

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<sup>19</sup> Nevertheless, they are entitled to charge the unrelated services rendered to BPOs, provided the foregoing conditions are met.

<sup>20</sup> Regional governments may provide for additional benefits for (regional) PBOs.

## II.2. 3. Slovenia

### II. 2.3.1. Private institutes.

Private institutes are non-membership organizations that can conduct activities in the areas of education, science, culture, sports, health, social welfare, children's care, care of the disabled, social security, or other not-for-profit activities. It may be established by domestic or foreign legal entities, and may engage in economic activities intended to further their objectives. Public institutes must provide "public services," or services available to the general public, which are otherwise the responsibility of the Government. As a norm, the Law does not mandate private institutes to provide "public services" or services available to the general public. A private institute may, however, seek permission from the competent public authority to provide such services. If permission is granted, a private institute becomes an "institute with public rights," and possesses the rights, obligations, and responsibilities of a public institute. **Private** institutes providing public services are the functional equivalent of the **Slovakia** not-for-profit organizations providing publicly beneficial services (NPOs).

### II.2.3.2. Public Benefit Organizations.

Slovenia **has not** developed a comprehensive concept of **public benefit organizations**. Rather, an association that engages in public benefit activities as defined by the Law on Association may apply with the competent ministry for the status of "an association in the public interest". A minister responsible for the field in which the association operates decides on the status and keeps the Registry of Public Interest Associations. The criteria for obtaining this status can vary depending on the ministry in question, though the basic criteria are prescribed by the Law. The chief among them are that an association must have the legal entity status at least two years prior to the application for a public interest status, and that in the same period preceding the application it has regularly implemented programs, projects or other activities in order to further its goals for public interest. Some public benefit activities of associations are regulated by special legislation, such as the Law on Humanitarian Organizations and the Law on Organizations for the Disabled, which set forth special procedures for attaining public benefit status by those and define some of the rights and obligations that accompany such a status.

### II.2.3.3. The Law on Social Entrepreneurship.

*Definition of Social Entrepreneurship.* As already noted, in 2011 the Slovenia introduced the Law on Social Entrepreneurship. The Law defines **social entrepreneurship** as regular pursuing of "social entrepreneurship activity" or regular performance of any other activities, under special conditions set out for

employment, production and sale of products or services in a market where **profit** is **not the exclusive** or main aim of the activity. “Social entrepreneurship activities” can be carried out in any of the following fields: social care; family care; protection of persons with disabilities; science; research; education; providing and organizing youth work; the protection and promotion of health; social inclusion; promoting employment and vocational training for persons who are unemployed or facing unemployment; job matching for vulnerable groups (employment agencies); organic food production; nature conservation; management and protection of the environment and animal welfare; promotion of renewable energy and developing green economy; country tourism; social and fair trade; culture, technical culture and preservation of cultural, technical and natural heritage; amateur sports and physical culture, whose purpose is recreation and socialization; rescue and protection; encouraging the development of local communities; and, support services for social enterprises. The Law does not set out which concrete activities in the stated fields are “social entrepreneurship activities”; this is left to the Government to address in the implementing regulation, which is yet to be enacted.

*Definition of Social Enterprise.* Under the Law, any **private legal person** which fulfils the following criteria is deemed a SE: 1) it is established to pursue qualified public benefit goals or to facilitate employment of the recognized vulnerable groups, rather than to generate profits; 2) it engages in regular production of good and provision of services on the market; 3) it is governed **democratically** (one member, one vote), rather than by contribution to the share capital; 4) it engages volunteers in its activities; 5) it provides for worker and volunteer participation in the decision-making process; 6) it does not distribute profits among members and affiliated persons thereof, or distribute it to a limited extent. Based on the foregoing criteria, in addition to associations, foundations and private institutes (*supra*), the Law also enables **a commercial company** to operate as SE, if it meets the prescribed conditions, including non-distribution or limited distribution of profits (20% of the overall profits, as provided by the Law), and **democratic** governance. In practice, this would typically pertain to **labor insertion companies**, if so provided by their statute, given that they are otherwise subject to rules governing commercial companies. Cooperatives may not operate as SE, because they can only pursue mutual benefit goals.

*Types of SE.* The Law explicitly provides for two types of social enterprises: 1) **type "A"**, which: carries out (one or several) “social entrepreneurship activities”; employs at least two workers, and generates at least 50% of its total revenues from “social entrepreneurship activities”; and 2) **type "B"**, which can engage in any type of business, but at least one third of all employees most come from the most vulnerable groups in the labor market (long-term unemployed, disabled, Roma and others). The status of SE is approved by the authority responsible for the initial registration of the legal entity applying for that status.

Based on the foregoing there are some notable similarities and differences in the **framework regulation for social enterprises** in Italy, Spain and Slovenia, which are summarized as follows<sup>21</sup>:

SIMILARITIES:	DIFFERENCES:
<p>The primary purpose of the framework regulation for SE is to make the social economy more visible.</p> <p>"Open model" of SE, no distinct institutional form.</p> <p>Emphasis on policy measures, other than providing specific tax and other financial benefits (with the exception of Slovenia).</p> <p>Concept of SE much broader than work integration and social inclusion; includes host of activities deemed for public benefit (and in case of Spain, mutual benefit).</p>	<p><i>Italy</i>: no request for SE democratic governance (but only stakeholders' participation);</p> <p><i>Spain and Slovenia</i>: SE must be <b>democratically governed</b>. Implication of this requirement. for non-membership organizations (foundations, private institutes) and commercial companies on their social enterprise status <b>not clear</b>.</p>

## II.2.4. United Kingdom

### II.2.4.1. Introduction.

There is no a legal definition of a SE in the U.K. The Government defines a SE as: "a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners".<sup>22</sup> The government's definition is thus concerned with the nature of the organization's activities, rather than the legal forms in which they operate. In its simplest form, a SE can be a sole trader who has decided to donate the majority of generated profit to social purposes (good cause), or a partnership. SE may also take an unincorporated legal form, such as an unincorporated association or a trust (or a combination of the two). However, because of tax and other ensuing benefits associated with incorporation (limitation of business risks; clear ownership structure; developing a sense of ownership;

<sup>21</sup> Developed by Dragan Golubović.

<sup>22</sup> "Social Enterprise: A Strategy for Success", op. cit. p. 17.

accountability and disclosure giving public confidence; recognition by financial institutions and investors; and availability of equity finance), most SE operate in the form of the limited liability company, the community interest company (CIC), and industrial and provident society. Some SE also operate in the form of the limited liability partnership (LLP). The purpose and the nature of a particular SE, including the benefits and obligations attached to the specific legal form, will usually determine the institutional tool of choice.

#### II.2.4.2. Limited Liability Company.

There are two kinds of limited liability companies: company limited by guarantee (CLG), which may be established by one or more persons, and company limited by shares (CLS), which may be established by at least two persons. There is a major distinction between CLG and CLS in that members of the former do not have a right to share in dividends or distribution of the remaining assets, in case of the dissolution of the company. In addition, CLG may be **democratically** governed (one member–one vote), and its members may play a **consultative** role in the management of the company; the features which make CLG a common institutional form of choices for charities, trade associations and not-for-profits, but also bring CLG closer to the ideal type of social enterprises (*supra*, I. 2). There is also the possibility of creating different categories of members representing different constituencies, e.g. local authority members, users' members. If members wish that CLG or CLS pursue social goals they need to define those goals in the founding documents, or if they subsequently wish to transform a company into a SE, they need to convene the general meeting and adopt a special resolution to that effect. This transformation is not irreversible, as members retain the right to amend or annul such resolution and restore the for-profit goals of a company. However, in case of a wholly-owned trading subsidiary of a charity, or if shares are given to other benefitting from a SE, this is likely not to be an option.

#### II.2.4.3. Community Interest Company.

*Definition.* A community interest company (CIC) was introduced in 2004<sup>23</sup> as a distinct type of company and regulated in detail by the Community Interest Company Regulations of 2005.<sup>24</sup> The reason for introducing CIC was to offer a greater choice and flexibility of institutional forms suitable to operate as SE. CIC is a limited liability company which is established to further business in order to benefit community, rather than to generate profits. It mostly operates in the form of company limited by guarantee (CLG), while very few operate in the form of a company limited by shares (CLS). There is an important institutional distinction

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<sup>23</sup> Available at: [http://www.legislation.gov.uk/ukpga/2004/27/pdfs/ukpga\\_20040027\\_en.pdf](http://www.legislation.gov.uk/ukpga/2004/27/pdfs/ukpga_20040027_en.pdf)

<sup>24</sup> The principal instrument governing CIC is the Companies Act of 2006, which is currently in force. The CIC Regulations were amended in 2009 in order to align with the 2006 Companies Act.

between the CICs and CLG/CLSs in that CICs are *required by law* to state in their articles of association their social purpose ("the community interest test"), and have provisions governing an 'asset lock' and cap on the maximum dividend and interest payments it can make (*infra*). In addition, a CIC may convert into a charity, or into a community benefit society, but once established it may not convert into a standard limited liability company. It is said that CIC structure provides a clear signal to investors that the enterprise operates for the benefit of the community, and that this social purpose is protected by proportionate regulation.

*Key Features.* As already noted, the key features of CIC are the "**community interest test**" and the "**asset lock**", which ensure that a CIC is established for community purposes and that assets and profits are dedicated to those purposes. There is no minimum founding capital requirement for CIC. It may be established as a new company, however, the already operating company may also transform into CIC. In either case, a company must provide evidence in the form of a community interest statement that it meets the **community interest test**. It doesn't mean to imply that each activity of the applicant company shall be directly beneficial to the community, or a defined section thereof, but rather that its overall activities shall contribute towards achieving the defined community-benefit purpose. In addition, the statement contains a description of how any surpluses will be used by the company, and a declaration that the company will not be a political party, an advocacy organization for a political party, or a subsidiary of a political party or advocacy organization for a political party. An independent public office holder, the Regulator of CIC, decides whether a company is eligible to be formed as a CIC and provides guidance and undertakes supervision throughout their operation.

**The asset lock** rule does not prevent CIC from using its assets in the course of regular trading and other business activities, but rather it prevents it from distributing those assets for less than the market value (except in case it is transferred to another asset-locked organization, *infra*). CIC may distribute assets to their members and pay interest on debentures and debts in conformity with the limitations set out by the CIC Regulations. Those limitations pertain to the distribution of dividends, the reduction of share capital, and the distribution of assets. The directors may receive remuneration for their services, however, in the light of the community interest test and the asset lock rule (*supra*), it must be reasonable and transparent.

As compared to ordinary and charitable companies (i.e. companies established by charities to generate income to further their public benefit goals), CIC offers several benefits, as presented below.<sup>25</sup>

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<sup>25</sup> <http://www.bis.gov.uk/assets/cicregulator/docs/leaflets/10-1388-community-interest-companies-benefits-of-a-cic-leaflet>



Compared to an ordinary company:	Compared to a charitable company:
<ul style="list-style-type: none"> <li>• Asset lock;</li> <li>• Statutory provisions which prevent members from removing the asset lock provision by a special resolution;</li> <li>• Regulation to ensure that CIC maintains its asset lock and provides benefit to the community it was set out to serve;</li> <li>• Checks and balances provided by CIC regulation;</li> <li>• Community benefit report open to the public;</li> <li>• Transparency of directors' remuneration and use of assets;</li> <li>• Legal protection from demutualisation and from windfall profits being paid to directors and members.</li> </ul>	<ul style="list-style-type: none"> <li>• Flexibility in terms of activities;</li> <li>• No trustees and trustee control;</li> <li>• The directors can be paid;</li> <li>• Light-touch regulation;</li> <li>• Fewer reporting requirements and administration.</li> </ul>

However, CIC **does not** enjoy any tax or other corresponding benefits, which makes it a less attractive form as compared to charities (*infra*, Chapter III).

#### II.2.4.4. Industrial and Provident Societies (IPS).

IPS is a distinct legal form conducting business or trade which is mainly used to benefit local communities (*community benefit society*) or to set up a consumer, agricultural and housing cooperatives (*bona fide* cooperatives, commonly known as co-operative or co-operative society). IPSs are registered and administered by the Financial Services Authority. Similar to companies, not all IPSs meet the definition of a SE.

#### II.2.4.5. Charities.

*Definition.* Charities (public benefit organizations) are governed by the Charities Act of 2011, which defines charity as body or trust which is for a charitable purpose that provides benefit to the public. Thus, similar to other countries surveyed which have the charity regulation (Italy, Spain), a charity is not a distinct institutional form.

Most charities operate as companies limited by guarantee, industrial and provident societies, and trusts, but they may also operate as unincorporated associations. Charitable purposes are deemed only purposes specifically listed in the Charities Act, or other purposes that are currently recognized as charitable, or are in the spirit of any purposes currently recognized as charitable; this allows new purposes to be also recognized as charitable by the Charity Commission or the High Court. A charity may not be formed for the purpose of engaging in political activities, however, it may engage in some political activities as a means of achieving its charitable purposes. While many SE operate as charities, not all of them necessarily regard themselves as SE; it will ultimately depend on the nature of their goals and activities.

*Governance.* A charity typically has a single-tier governing body with members known as trustees, directors, board members, governors or committee members (trustees). It is considered as a good practice to have at least 3 trustees in the governing body.

*Income.* A charity may generate income from fundraising, grants, donations, passive or direct investments and other legitimate sources. In order to make investments in the best interest of the charity, the Commission recommends adopting a clearly recorded and regularly reviewed investment policy. It also prepares a guidance for charities on both fundraising and managing assets and resources.

*Economic Activities.* A charity may engage in economic activities which further the primary purpose of the organization (**“primary purpose trading.”**). Examples include: the provision of educational services by a charitable school or college in return for course fees; the carrying out of trading involving the charity's beneficiaries; the holding of an art exhibition by a charitable art gallery or museum in return for admission fees; the provision of residential accommodation by a residential care charity in return for payment; the sale of tickets for a theatrical production staged by a theatre charity; and the sale of certain educational goods by a charitable art gallery or museum. Commercial and economic activities other than the exceptions set out above cannot be conducted directly by the charity. However, any commercial and economic activities can be conducted through a for-profit subsidiary with the profits then transferred tax-free to a charity. Many charities now have trading subsidiaries for fundraising purposes (*infra*, Chapter III).

*Distribution of Income and Assets.* A charity may not distribute profits as dividends or otherwise, and all expenditures must further the organization's charitable purposes. This principle applies to salaries as well as other expenditures. As a general rule, trustees may not receive payment for their services or be employed by the charity, unless the charity's governing documents permit it. If the governing

documents do not contain such a provision, the charity must seek authorization to that effect from the Charity Commission or the High Court of England and Wales.

The proprietary interests in the assets of a charity generally belong to a charity itself. Donors can, however, retain a proprietary interest in their donations by reaching an agreement with the charity at the time of the donation.

*Distribution of Remaining Property.* The assets of a charity, upon its dissolution, must be transferred to another charity or other charities pursuing the same or similar purposes.

#### **II.2.4.6. Charitable Incorporated Organization (CIO).**

CIO is a new incorporated form for a charity designed to offer a more efficient way to run a charitable venture without the burden of being a company. It is easier to establish a CIO than a CIC, since it becomes a body corporate by the registration in the Register of Charities and does not need to be registered at the Companies House. The rules of CIOs are laid down in Part 11 of the 2011 Charities Act.<sup>26</sup>

A CIO is managed by charity trustees and may have one or more members. A CIO may be set up in a way that members are not liable to contribute to the assets of the CIO if it is wound up, but the constitution of the CIO may also regulate that they are liable for the debts incurred by the organization up to a certain amount. A CIO must use and apply its property to further its statutory purposes and in accordance with its governing documents.

### **II.2. 5. Austria**

#### **II.2.5.1. Introduction.**

Austria does not have a framework regulation for SE and generally has a rather narrow concept of the social economy, which is primarily concerned with social inclusion and work integration. Social inclusion is primarily carried out by two types of "social enterprises": socio-economic establishments (SÖB) and non-profit employment projects/enterprise (GBP), which operate as **associations** or **not-for-profit limited liability company** (gGmbH). Sheltered workshops are governed by the Disabled Persons Employment Act; they operate as a regular commercial company (GmbH) and thus fall out of the remit of this Report. Cooperatives are not used as forms for SE due to their mutual character.

#### **II.2.5.2. Not-for-Profit Limited Liability Company (gGmbH).**

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<sup>26</sup> Available at: <http://www.legislation.gov.uk/ukpga/2011/25>

GGmbH is a limited liability company which is established to pursue public benefit (not-for-profit) goals, rather than generate profits. It is expected to become a viable legal form for SE in Austria, not least due to certain tax benefits it enjoys (*infra*, III).<sup>27</sup> The *gGmbH* is principally governed by the Law on Limited Liability Company (*GmbH-Gesetz*) of 1906. The Law does not envisage the “public benefit (non-profit)” purpose (“*gemeinnützige*”) as one of the legitimate purposes of GmbH, rather, the public benefit concept of GmbH has been developed in tax law. Accordingly, tax benefits are provided for any organization (GmbH included), which pursues public benefit (nonprofit, charitable or religious goals) and its assets are solely and directly used to further those goals. A purpose is deemed for public benefit in case its implementation supports the community at large in intellectual, cultural, moral or material terms (promotion of health care, art and science, care for old, public education, nature etc.). A group of individuals is not considered as general public in case there are close ties between the beneficiaries and the organization, or in case the number of eligible beneficiaries is insignificant. In addition, *gGmbH* (or for that matter other public benefit organization): may not generate profit or pay dividends to its shareholders; its shareholders, following the termination of the organization, may not receive in return more than their paid-up equity share and the fair market value of their contribution; it may not have the overhead costs exceeding 8% of its annual income; and, in case of the dissolution, the remaining proceeds of the organization must be destined for public benefit purposes.

### II.3. Supervision and Reporting Requirements for SE.

#### II.3.1. Introduction.

As the foregoing suggests, in all the countries concerned SE are private legal entities and therefore are subject to the general reporting requirements otherwise prescribed for private legal entities (profit and not-for-profit). As such, they do not merit a particular attention, given that they have been sufficiently harmonized at the EU level, in particular due to the Fourth Council Directive 78/660/EEC of 25 July 1978 on Annual Accounts and its National Transpositions.<sup>28</sup> However, in some of the countries concerned (Italy, Spain, and U.K.) there are additional reporting requirements for SE. While those requirements differ to some extent, what is common to them is an obligation for a SE to submit a **social mission report**. Generally, there are **two types** of **social mission** reports recognized in Europe: “a bound content” and a “measurement type” of social mission reports. The former is

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<sup>27</sup> Othmar M. Lehner: The Phenomenon of Social Enterprise in Austria: A Triangulated Descriptive Study. *Journal of Social Entrepreneurship*, March 2011.

<sup>28</sup> Bagnoli L & Toccafandi S: “Reporting frameworks for social enterprises: A European Overview”, CIRIEC, Working paper No. 2011/09, p. 20.

argued not to meet the requirement of social accounting for several reasons, including the rigidity of the model, which does not make it possible to add information which better represents the social effectiveness of a specific SE, and the fact that social performance is not measured by qualitative/quantitative indicators, while disclosure is limited to one or only few classes of stakeholders. In this respect, the latter type features several advantages, including the flexibility of its structure and content, and the qualitative/quantitative description of activities carried out, highlighting the correlation between activities and social purpose, using the outcome and the output indicators to measure the impact community indicators of SE. The **outcome indicators** focus on qualitative results, with an eye of assessing the resulting benefits of SE activities for the designated beneficiaries e.g. the impact of a social assistance program. The **output indicators** relate to the quantitative impact of SE activities e.g. the number of families assisted under a housing program; or the number of people benefited from the bank food program. The **impact community indicators** measure medium and long-term impact of a SE on the development of social capital and community well being, e.g. reduction of number of drug addicts in a community.<sup>29</sup>

As discussed below, all the countries concerned have embraced the "measurement type" of social mission reporting, albeit with various degree of success. Because of the role of public benefit organizations in the SE concept in those countries (*supra*), the supervision and reporting requirements for PBOs are also briefly discussed below.

### II.3.2. Italy

The Ministry of Finance is vested the general power to oversee the compliance of any private legal entity with tax, accounting and financial rules. An **independent and certified auditor** must approve the annual financial statement of public benefit organizations (PBOs) and **social enterprises**.

The **reporting requirements** for PBOs and SE operating as NGOs are similar, noting that there is no single reporting requirements for a SE. Rather, they depend on the legal form in which they operate (commercial or non-commercial). A SE must file with the Ministry of Labor and Social Policies the annual balance sheet (the content of which depends on the nature of the legal form of SE) and the **social mission report** (the *social balance sheet*). The latter details activities carried out in pursuit of a SE's main statutory goal. A SE must consult the Agency for the Third Sector, before it submits the social mission report. However, it is argued that the social mission report does not contain sufficient qualitative information to measure the social impact of a SE's activities.

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<sup>29</sup> Ibid, p. 21 and further.

PBOs which seek to enjoy tax benefits must be entered into the registry with the Ministry of Finance. The Agency for the Third Sector, which is created by the Legislative Decree NO. 329/2001, is vested the power to check the compliance of the applicant organization with the criteria set out for the public benefit status in the Law and generally oversees activities of PBOs. In addition, the Agency has the power to propose legislation impacting on the NGO sector and monitors data pertinent to the third sector. Public benefit organizations must submit their annual balance sheets to the Ministry of Finance and their annual report of activities to the Agency.

### Challenges in the reporting requirements for SE in Italy:<sup>30</sup>

**How to design a "social report"**, which will facilitate verifying a SE's ability to answer the social purpose for which it has been established. Its peculiar nature makes it a challenge to use for-profit effectiveness indicators, which are mostly based on financial data; more precise **outcome** and **output** indicators are required, in order to measure the **impact community** of SE.

### II.3.3. Spain

The Director General of Social Economy and Social Responsibility of Business is vested the power of general oversight over cooperatives. The general accounting rules for cooperatives pertain to social cooperatives (CIS). A cooperative must file with the Registry of Cooperatives the annual balance sheet, the profits and loss accounts, notes on the accounts, the statement of changes in equity, the statement of cash flow, and the annual activity report (the **social report**), unless it is eligible to draw a simplified balance sheet, pursuant to the rules set out in the Law on Limited Liability Companies, in which case it does not have to file the social report; this occurs if it is classified as small and medium size enterprise. In addition, the activity report is **not mandatory** at national level, rather, it is within the discretionary power of the respective autonomous regions. Based on the data available, few regions have embraced social reports thus far.

The tax authority is responsible for supervising the compliance of any legal entity with tax and accounting rules, as well as for supervising the compliance of NGOs with the public benefit requirements. In addition to filing the annual balance sheet, a PBO must also file with the tax authority a report on its activities, which demonstrates that those served public at large or designated social or geographic group. While a division of responsibilities between the registration authority

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<sup>30</sup> Developed by Dragan Gollubović.

(*Protectorado*) and tax authority over PBOs does not seem clear-cut, it is the tax authority which is vested the power to grant and revoke the public benefit status, in cases of repeated and egregious violation of law. If a public benefit status is revoked in due process, the organization no longer qualifies for tax benefits, but does not necessarily cease to exist.

### Challenges in the reporting requirements for SE in Spain:<sup>31</sup>

Filing of a social report **is not mandatory** at state level;  
The content of social report needs to incorporate sufficient **outcome** and **output** indicators, to measure the **impact community** indicators.

#### II.3.4. United Kingdom

The community interest company (CIC) is supervised by an administrative authority, the Regulator, which has the monitoring and the sanctioning power, including the power to appoint/remove a director and the power to file a petition for the winding up of the CIC. As a general rule, the CIC is obliged by the reporting requirements otherwise prescribed for companies. These include filing the annual balance sheet, the profit and loss account, and the notes on the accounts. In addition, the CIC is obliged to file with the Regulator the annual **community interest report**, which consists the following information; (a) a fair and accurate description of the manner in which the company's activities during the financial year have benefited the community. For that, CIC uses the **outcome** and the **output** indicators as recommended by the Regulator; (b) a description of the steps, if any, which CIC has taken during the financial year to consult beneficiaries of its activities and the outcome of any such consultation; (c) information regarding chairman's and directors' emoluments; (d) transfers of assets other than for full consideration; and (e) information regarding the declaration of dividends, transfer of assets, and remuneration of debentures.

As the foregoing suggests, the community interest report for the CIC is more elaborate than in the case of similar reports in Italy and Spain. Because the concept of the CIC is fairly new, it remains to be seen, however, whether it will significantly facilitate the determination of the overall community impact of a SE.

A charity (public benefit organization) whose annual income exceeds £ 5,000 must registered with the Charity Commission for England and Wales (currently 162,136

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<sup>31</sup> Developed by Dragan Golubović.

organizations), which is the supervising authority for charities. The Commission is a quasi-judicial body, which is independent of Ministerial influence. In addition to supervising charities, it assist them in complying with law, through publishing and training activities.<sup>32</sup> A charity files its annual account sheet and a report of its activities with the Charity Commission, which in many ways is similar to the community interest report.

### **Challenges in the reporting requirements for SE in U.K.:<sup>33</sup>**

Ensuring an ongoing monitoring of the current social reporting requirement is critical to determine if it fulfills its underlying role.

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<sup>32</sup> <http://www.charity-commission.gov.uk>

<sup>33</sup> Developed by Dragan Golubović.



### III. POLICY MEASURES PERTINENT TO SE.

#### III.1. Policy Measures Pertinent to Public Financing of SE.

##### III.1.1. State Aid: EU Rules and Their Impact on the National Regimes for SE.

*Definition.* The term: "**State aid**" is a European Commission (EC) term referring to forms of assistance which public bodies, or publicly-funded bodies, give to "**undertaking**" on a discretionary basis, with the potential to distort competition and affect trade between Member States.

*Goals and Rationale.* The State aid rules aim to ensure fair competition. Giving favored treatment to some businesses would harm their competitors and risk distorting the market; hinder the long-term competitiveness of the European Union (EU) by unduly propping up inefficient, aid-dependent businesses; and allow economically more potent Member States to favor their own industries. The State aid rules contribute to the effective functioning of the Single Market and the EU economic reform in two key ways: 1) they prevent a state aid that would seriously distort competition - thereby helping to achieve a fair market for businesses in all Member States; 2) they allow a state aid that promotes economic development and other legitimate policy objectives, where this benefit outweighs any distortion of competition. The **State aid** rules also **apply** to funds from the **EU** institutions (*infra*).

*Sources of Legislation.* The State aid rules are enshrined in a number of articles of the EC Treaty, in particular Article 87 and 88, and various regulations, frameworks and guidelines issued by the EC, which set out in detail what kind of a state aid is permissible (*infra*, Annex III). The basic framework for State aid is provided in **Article 87**, Paragraph 1, of the **EU Treaty**, now Article 107 of the Treaty of the Functioning of the European Union, which prohibits states aid: "in any form, whatsoever, which **distorts or threatens to distort competition** by favoring certain undertakings or production of certain goods, insofar as its effects on trade between Member States be incompatible with the common market" (emphasis ours). Exceptions from this general rule are laid down in Paragraph 2, in recognition that in some circumstances, government intervention is necessary for a well-functioning and equitable economy.

*Definition of Undertaking.* Chief to the implementation of the State aid rules is the definition of "**undertaking**". There is no official definition of undertaking as referenced in Article 87, Paragraph 1 of the EU Treaty, however, the EC deems **any organization** involved in **economic activity** an undertaking. This also includes not-for-profit organizations (public benefit organizations, social enterprises, universities) and public bodies when engaged in economic activities. The key,

therefore, which triggers the State aid rules is the **nature of the activity**, rather than the **form of the organization**. How surpluses from economic activities are allocated – whether distributed to shareholders, used for social aims, or re-invested makes, no difference in the State aid terms.

*Threshold Test.* There are several conditions that have to be cumulatively met in order for a state aid to give rise to the issue of distorted competition:

1) **Is the measure granted by the state or through state resources?** State resources not only include obvious sources, such as funding from central government, local authorities and local enterprise networks, but also funding which falls under the control of the state, such as the lottery funds, but also the **EU structural funds**, including the **European Social Fund**, which plays a key role in the **EU 2020 Strategy for Growth and Jobs**.<sup>34</sup> Public **purchasing** of activity or services at commercial rates **do not** constitute state aid, as the market has not been distorted.

2) **Does it confer an advantage to an undertaking?** An advantage might be conferred by a **grant** or by a less obvious measure, such as a **loan** or **services** on favorable terms i.e. below market rate or, for example, subsidized training or consultancy. Loans at commercial rates are deemed the state aid.

3) **Is it selective, favoring certain undertakings?** That is, is the state aid only available to certain undertakings? That could mean that it is only available to a particular organization, or to a number of organizations located within particular areas. Funding which is available to all undertakings throughout a particular country is not considered selective, but a ‘general measure’ which is not the state aid e.g. UK-wide tax breaks available to all undertakings.

4) **Does the measure distort or have the potential to distort competition?** Important for SE, the potential to distort trade and competition **does not have to be significant** for this ‘test’ to be met.<sup>35</sup> Such potential may exist even where small amounts of public funding are given to undertakings with little market share. On the other hand, the EC has taken a view that public funding to an undertaking not to have a potentially distortive effect on intra-Community trade and competition where the activity or service provided was aimed at a strictly localized market, does not amount to the State aid. For example, in "*Partnership support for regeneration Community/voluntary (neighbourhood) regeneration*" (N546/B/2000), the EC found the English public funding to exclusively non-profit, very small scale bodies in the voluntary/community sectors (active in areas such as very local community education and youth work) not to amount to the State aid. This was on the basis that

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<sup>34</sup> <http://ec.europa.eu/esf/home.jsp>

<sup>35</sup> BUG-Alutechnik GmbH (1988 OJ L 79/29).

the funding recipients provided their services exclusively to the local community; that the recipients were non-profit making and distributing; were largely run by unpaid volunteers living in the local community, with very few or no paid employees; and had a very limited budget.

**5) Is the activity undertaken by a beneficiary tradable between Member States?** The EC interpretation of this is broad - it is sufficient that a product or service is subject to trade between Member States, even if the aid beneficiary itself does not export to the EU. Consequently, most activities are viewed as tradable. Some activities defined as 'local', which are considered not to affect inter-state trade, where delivered by small enterprises, include: repair of personal and household goods; health and social work; other community, social and personal service activities; social services; construction; sale, maintenance and repair of motor vehicles and fuel; and hotels and restaurants.

*De minimise rule.* This rule pertains to the **scale of public support** which does not trigger the application of the State aid rules. The EC Regulation 1998/2006 (de minimis aid regulation) considers that public funding or support (e.g. grants, loans, subsidized contracts etc) from all public sources provided specifically as de minimis funding to a single recipient up to €200,000 over a 3 year fiscal period has a negligible impact on trade and competition, and does not require *ex ante* notification (*infra*). This aid can be given for most purposes, including operating aid and is not project-related. The €200,000 is a threshold prescribed for the state aid, not necessarily for all public support to an organization, which may include funding of non-economic activities (see also *infra*. 1.4.)

*Block Exemptions.* Where public funding constitutes the state aid, it must comply with the EC's State aid rules and be provided as **compatible aid** (*infra*). That is, it must conform to the specific scope to award State aid and permissible aid intensity levels set out by the EC in its various guidelines, frameworks and the new EC's General Block Exemption Regulation (GBER) introduced in 2008.<sup>36</sup> The GBER enables support towards the following:

- Regional aid (investment and job creation);
- SME investment and employment aid);
- Aid for female entrepreneurship;
- Aid for environmental protection;
- Aid for consultancy and SME participation in fairs;
- Aid in the form of risk capital;
- Aid for Research Development & Innovation;
- Training aid;

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<sup>36</sup> [http://ec.europa.eu/competition/state\\_aid/reform/gber\\_final\\_en.pdf](http://ec.europa.eu/competition/state_aid/reform/gber_final_en.pdf)

- Aid for disadvantaged and disabled workers.

There are restrictions imposed on the scope of aid and eligible costs associated with each activity. Training, consultancy, investment, employment (in particular of **disadvantaged groups**) and environmental protection are potentially all eligible areas of support by public funders as long as the undertaking involved meets the criteria set out in the GBER. Criteria set out with regard to **employment aid** are of particular significance for SE, given their role in work integration; this are elaborated in great detail in Article 15 of the Regulation.<sup>37</sup>

*Ex Ante Notification.* Aid may be awarded under the existing, appropriate state aid scheme of which the EC must be notified *ex ante*, or, where none exists, the EC must be notified for approval prior to any award of aid under an appropriate guideline or framework.

*Sanctions.* If the EC finds the undertaking to have met the foregoing tests, it has the power to seek **recovery** of any payment of illegal aid with interest, which extends back ten years.

### III.1.2. Public Procurement Rules and their Impact on SE.

#### III.1.2.1. The EU Rules on Public Procurement.

*Significance to SE.* The contracting out of the provision of goods or services is a key instrument for public authorities to support the mission of SE. This is particularly true for the local authorities and in the mixed welfare system moving towards an open market, with contract fees replacing the grants schemes. These developments pose a particular challenge for smaller service providers, many of them SE, for twofold reasons: 1) they face difficulties in managing the transaction costs of large contracting, since there is "a growing tendency for contracts to be packaged into larger units to achieve economies of scale";<sup>38</sup> 2) at instances where SE organisation provide multiple social outcomes: "there is the problem of transversal benefits i.e. where a contract delivers a positive outcome to another budget area".<sup>39</sup>

*Sources of Legislation.* The public procurement policy is one of the components of the Single Market policy, and therefore pertinent EU Directives provide a general

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<sup>37</sup> **Only 1/5 of total public expenditure** on goods and services is covered by the EU Directives. Commission Staff Working Paper: Evaluation Report on Impact and Effectiveness of EU Public Procurement Regulation, Part I, SEC(2011) 853 final .

<sup>38</sup> R. Spear, The Social Economy in Europe: Trends and Challenges, ([www. http://oro.open.ac.uk/32266/](http://oro.open.ac.uk/32266/))

<sup>39</sup> Ibid.

framework for the procurement law of the Member States.<sup>40</sup> Indeed, the public procurement rules play a pivotal role in determining the parameters under which public subsidies and state financing of public services trigger the State aid rules.<sup>41</sup> The EU public procurement directives seek to ensure the attainment of free movement of goods and the attainment of freedom of establishment, as well as freedom to provide services in respect of public works contracts. The attainment of these objectives: "necessitates co-ordination of public procurement procedures in order to ensure effective competition and non-discrimination in respect of such procedures and optimal allocation of public money".<sup>42</sup>

However, as the EC noted: "internal market policy can be pursued while at the same time integrating pursuit of other objectives, including social policy objectives".<sup>43</sup> The social policy has played a central role in building Europe's economic strength, through the development of a unique social model. While the current EU framework governing public procurement does not specifically recognize the pursuit of social policy goals within the framework of public procurement procedures, the EC took a stand as early as in 1998 that the current framework nevertheless offers a range of possibilities which, if properly pursued, should make it possible to accomplish desired social objectives. The social goal objectives reflect the nature of SE operating as NGOs in supplying social services for communities.

In 2001 the EC issued a more detailed Communication in this respect to strengthen its case (noting that it is the **European Court of Justice** which has the ultimate jurisdiction over that issue):

"This Communication aims to identify the possibilities under existing Community law applicable to public procurement for taking social considerations into account in the best way in public procurement. The Communication examines the different phases of a procurement procedure and sets out, for each phase, whether and to what extent social considerations can be taken into account".<sup>44</sup>

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<sup>40</sup> Council Directive 92/50/EEC of 18.6.1992 Relating to the Coordination of Procedures for the Award of Public Service Contracts; Council Directive 93/36/EEC of 14.6.1993 Coordinating Procedures for the Award of Public Supply Contracts; Council Directive 93/37/EEC of 14.6.1993 Concerning the Coordination of Procedures for the Award of Public Works Contracts, as amended by European Parliament and Council Directive 97/52/EC; Council Directive 93/38/EEC of 14.6.1993 Coordinating the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Telecommunications Sectors, as amended by European Parliament and Council Directive 98/04/EC.

<sup>41</sup> C. H. Bovis, Financing Services of General Interest in the EU, *European Law Journal*, Vol. 11. No. 1/2005, p. 79.

<sup>42</sup> Commission of the European Communities (2001) Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement. Brussels. COM (2001) 566 final, p. 4

<sup>43</sup> Ibid.

<sup>44</sup> Ibid, p. 5.

The Communication outlines possibilities for inserting properly defined social considerations ("social clause") in the contracts, depending on their types, and how it impacts on various stages in the public procurement process, as discussed below. The Commission has also produced a guide on "buying social", which is a tool facilitating public authorities buying goods and services in a socially responsible manner, consistent with the EU rules. It outlines the contribution which public procurement can make to social policy, with practical examples on a broad range of social issues, including promoting equal opportunities and employment opportunities; and improving labor conditions and social inclusion of vulnerable persons.<sup>45</sup>

*Social Consideration and Types of Contracts.* The Communication points that possibilities for the procurement rules to include criteria other than the best value for money, such as social or environmental criteria, vary from contract to contract. The EC argues that **public contracts for works and services**, in respect of which it is possible to lay down the manner in which the contract is to be performed, provide the best opportunity for a contracting authority to take account of social concerns. Certain service contracts targeted at a particular social category have, by their very design, a social objective: for example, a contract for training for long-term unemployed persons; or contracts for the purchase of computer hardware/services adapted to the needs of disabled persons.<sup>46</sup> The EC also argues that service contracts which have a social objective relate in most cases are services within the meaning of Annex IB of Directive 92/50/EEC or Annex XVIB of Directive 93/38/EEC and thus fall out of the detailed EU procedural rules, and in particular the rules on selection and award.<sup>47</sup>

If different solutions exist which would meet the needs of a contracting authority, the contracting authority has a discretion to define in a contract what it considers as corresponding best to its social concerns, provided the general rules and principles of the EU Law regarding free movement of goods and the freedom to provide services, in particular, are observed. Accordingly, the subject-matter of a public contract **may not** be defined in such a way that it has as its goal or results in preventing competitors from other Member States, including SE, to compete.

*Selection of Bidders* The EU public procurement rules set out two lists of criteria for selection: the personal situation of a bidder, which precludes it from competition (e.g. pending bankruptcy); and the economic, financial and technical capacity. As a general rule, there is no room for social criteria when assessing the bidder economic, financial and technical capacity. However, there are some notable

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<sup>45</sup> Available at [http://ec.europa.eu/environment/gpp/buying\\_handbook\\_en.htm](http://ec.europa.eu/environment/gpp/buying_handbook_en.htm)

<sup>46</sup> Communication, *ibid*, p. 6.

<sup>47</sup> *Ibid*.

departures from this rule. First, in the *Beentjes* case, the Court of Justice found that a condition regarding the employment of long-term unemployed persons had no relation to the bidder's suitability regarding its economic and financial standing and technical knowledge and ability. From there, the Commission deduced that contracting authorities can include in the agreement a condition relating to the **employment of long-term unemployed** when setting out conditions relating to the execution of a contract (*infra*).<sup>48</sup> Secondly, if a contract requires specific know-how in the "social" field, specific experience may be used as a criterion as regards technical capability and knowledge in proving the suitability of candidates.

*Award of Contracts.* The EU rules permit the use of two different criteria for the award of public procurement contracts: **the lowest price** and the **most economically advantageous** ("best value for money") offer. The social criteria are not specifically referenced in the pertinent EU rules related to the latter. However, the EC argues, if the term: "social criterion" is construed as a criterion that makes it possible to evaluate, for example, the quality of a service intended for a given category of disadvantaged persons, such a criterion may legitimately be used if it assists in the choice of the most economically advantageous tender within the meaning of the directives".<sup>49</sup>

*Additional Criterion for Award.* This concept was first referenced in the *Beentjes* case (*supra*). In Case C-225/98, the Court of Justice held that contracting authorities may award a contract on conditions **related to the combating of unemployment**, provided it does not give rise to violation of the fundamental principles enshrined in the EU law, but only if there are **two or more economically equivalent tenders** for a public authority to consider. This condition was regarded by the Member State in question as an additional criterion, and was considered only after tenders were compared from a purely economic point of view. Finally, the Court of Justice stated that the application of the award criterion regarding combating unemployment must not have any direct or indirect impact on bidders from other Member States, and must be explicitly referenced in the contract notice, so that potential contractors are aware of such a condition.<sup>50</sup>

*Execution of Contract.* The EC argues that contracting authorities have a wide range of possibilities for determining the contractual clauses on social considerations, provided the EU general rules governing public procurement are observed. Examples include:

- a clause stipulating that a successful bidder must employ a certain number or percentage of long-term unemployed or apprentices, without requiring the

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<sup>48</sup> *Beentjes* judgment of 20.9.1988, Case 31/87, Par. 28.

<sup>49</sup> Communication, *ibid*, p. 13.

<sup>50</sup> *Ibid*. p. 15.

- unemployed or apprentices to be from a particular region or registered with a national body, for instance, for the execution of a works contract, should not necessarily amount to discrimination against other competitors;
- the obligation to implement, during the execution of the contract, measures that are designed to promote equality between men and women or ethnic or racial diversity;
  - the obligation to recruit, for the execution of the contract, a number of disabled persons over and above what is laid down by the national legislation in the Member State where the contract is executed or in the Member State of the successful bidder.<sup>51</sup>

*Contracts Falling Out of the EU Rules.* The EU procurement rules apply only to certain public procurement contracts, and in particular those whose value equals or exceeds the relevant threshold set out in the pertinent directives. Under the EU law, it is for Member States to decide whether public procurement contracts not covered by the EU directives should be subject to national rules. Member States also have discretion, within the limits laid down by the EU law, to decide whether public procurement contracts which fall out of the ambit of the directives may be used to pursue objectives other than the "best value" objective. Without prejudice to national legislation in the field, contracting authorities have a discretion to apply social criteria in their procurement procedures, selection and award criteria, provided it does not give rise to the violation of the general rules and principles of the EU Treaty.

According to the EC, in the case of services contracts, this may involve establishing a policy aimed at promoting ethnic and racial diversity in the workplace, through, for example, instructions given to the persons in charge of recruitment, promotion or staff training, if it is consistent with the general rules and principles of the EU Treaty. In addition, practices that reserve contracts to certain categories of persons, for example, to disabled persons ("sheltered workshops") or to the unemployed, are permitted, insofar they do not discriminate against bidder from other Member States, or amounts to an unjustified restriction on trade.

### III.1.2.2. National Legislation on Public Procurement.

Despite the foregoing opportunities presented in the current EU framework for public procurement, the practice of inserting social criteria into public contracts which otherwise fall within the ambit of the EU rules governing state aid is not yet very common in Member States, including the countries examined. This is attributed to various factors. Firstly, the **rationale** for public authorities to begin addressing social issues in their supply chains is **not clear**. In addition, there is a **lack** of

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<sup>51</sup> Ibid, p. 17.



motivation by public authorities to embrace such practices, given the **complexity** of the EU procurement rules and the inherent risk of their violation. Sweden, for example, consider any social consideration in the national procurement regime subject to the EU rules the violation of those rules. Furthermore, there is pressure on costs, in particular when the economy is contracting, which favours the lowest price, rather than the best value criteria.<sup>52</sup>

**Italy** was the first Member State to introduce a social clause in public contracts subject to the EU rules. Following the enactment of the Law on Social Cooperatives in 1991 (*supra*, Chapter II), the practice of preferential purchasing arrangement of social co-ops (type "A") with municipalities was introduced. However, this was contested by the European Commission as a breach of competition law, which prompted the revisions in the Law, enacted in 1996. The revisions obliged municipalities to further specify the social goal with regard to employment of a minimum number of disadvantaged persons, which permitted social cooperatives to retain their privileged position as service providers with municipalities.

In **Spain**, SE are subject to general public procurement rules, which are set out by the 30/2007 Law on the Public Sector Contracts.<sup>53</sup> The recently enacted framework regulation for social enterprise (Royal Decree 3/2011), creates a new momentum for legislative changes in this respect. The Seventh additional provision of the Decree (*Program for Promotion of Social Enterprise Entities*) provides that within **six months** following the enactment of the Decree the Government shall pass a program for the promotion of SE, with special attention paid to those rooted in local communities and generating employment in the least developed sectors. This program shall reflect the following measures, among others:

- Following consultation with the entities representing the social economy, the Council for the Promotion of the Social Economy and the Autonomous Communities, shall revise the legislation necessary to eliminate the limitations of the entities of the social economy, in such a manner that these may operate in any economic activities without any unjustified obstacles (Paragraph 1);
- Following consultation with the entities that perform social action, it shall revise the legislation developing General Law 38/2003, of 17 November, on Subsidies, with the purpose of simplifying the procedures regulated in the same (Paragraph 2).

The foregoing measures are yet to be taken, which presumably had to do with the current economic crises and the Government's pressing priorities in this respect.

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<sup>52</sup> Spear, *Ibid*.

<sup>53</sup> Deforny, Nyssens, *Social Enterprise in Europe: Recent Trends and Developments*, EMES, WP no. 08/01 p. 11.

The new **Slovenian** Law on Social Entrepreneurship also provides for a privileged position of "social enterprises" in public procurements, which employ vulnerable groups and disabled as defined by the Law (social enterprises type "B"). Namely, with respect to the procurement of goods and services related to work integration and training, at least 30% of annual public tenders must be reserved to those SE (the so called **reserved public tenders**).

**Public procurement** procedures are covered in **Austria** by the Public Procurement Act (BVerG)<sup>54</sup> in force since 1 February 2006. The responsible authority for the procurement of goods and services for public departments and public customers is the Public Procurement Agency (BBG Bundesbeschaffung GmbH)<sup>55</sup>, set up in 2001 by the BB-GmbH Act (BB-GmbH Gesetz)<sup>56</sup>. The Public Procurement Act (Article 19) spells out the basic principles and the general provisions for public tenders. Article 19(6) states that „[...] the employment of women, of people in a training relationship, of long term unemployed, of people with disabilities and elder jobholders, as well as the realization of other socio-political interests can be taken into consideration in the public tender process. This can be achieved in particular by considering such aspects in the description of the service, in the definition of the technical specifications, through the definition of specific award criteria or through the definition of conditions in the service contract.”<sup>57</sup> The above paragraph clearly suggests that social aspects may be taken into account as award criteria for public tenders. Article 21(1) of the Law further states that „the awarding authority can stipulate that only sheltered workshops or non-profit employment enterprises can participate in the public tender, or that the tender is reserved for such workshops or enterprises where the majority of the workforce is disabled who cannot carry out an occupation under normal circumstances due to the nature or the severity of their disability.”<sup>58</sup>

As mentioned in the official booklet of the Working Chamber of Upper Austria (Oberösterreich), Article §21 of the Law underpins and strengthens Article §19.<sup>59</sup> i.e. allows for „preferential treatment” for sheltered workshops, public benefit associations and socio-economic establishments (SÖB).<sup>60</sup>

On the other hand, social criteria do occur frequently in the procurement practices which otherwise fall out of the scope of the pertinent EU Rules. In the **U.K.** the revised **Compact** on the relationship between the government and the voluntary

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<sup>54</sup> <http://www.bka.gv.at/DocView.axd?CobId=16901>

<sup>55</sup> <http://www.bbg.gv.at/>

<sup>56</sup> <http://www.parlament.gv.at/PAKT/VHG/XXI/II/00486/index.shtml>

<sup>57</sup> <http://www.bka.gv.at/DocView.axd?CobId=16901>

<sup>58</sup> <http://www.bka.gv.at/DocView.axd?CobId=16901>

<sup>59</sup> [http://www.arbeiterkammer.com/bilder/d48/Oeffentliche\\_Auftragsvergabe.pdf](http://www.arbeiterkammer.com/bilder/d48/Oeffentliche_Auftragsvergabe.pdf)

<sup>60</sup> [http://www.arbeiterkammer.com/bilder/d48/Oeffentliche\\_Auftragsvergabe.pdf](http://www.arbeiterkammer.com/bilder/d48/Oeffentliche_Auftragsvergabe.pdf)

sector,<sup>61</sup> commits the Government to ensure that NGOs have a greater role and more opportunities in **delivering public services**, in accordance with wider public service reform measures, and **reforming the commissioning and procurement** environment in existing markets (3.1.); to ensure a well-managed and **transparent** application and **procurement** processes, which are **proportionate** to the desired objectives and outcomes of programs (3.5.); to agree with NGOs how outcomes, including the **social, environmental** or economic **value**, will be monitored before a contract or funding agreement is made (3.6.); to apply the Compact when distributing the EU funds. Where conflicts arise with the EU regulations, to **discuss** the potential effects and **agree on solutions together** (3.12); to demonstrate the **social, environmental** or economic value of the **programs and services** provided, where appropriate (3.17). The foregoing principles enshrined in the national Compact (as well as the local ones) have particularly found their application in the areas of employment, training and urban regeneration.<sup>62</sup>

### III.1.3. State aid: Moving Away?

As the foregoing analyses suggests, the State aid rules are complex and difficult to interpret not only by private actors, but also by policy makers. This has already shown an adverse impact on "undertakings", SE included. For example, in the U.K. the State aid rules are recently increasingly cited as a possible obstacle for public grants, loans and development support. This is reinforced by practice of inserting a clause in grant agreements requiring the grantee to **indemnify public authority**-the contractor if the grant in question is subsequently found to constitute unlawful State aid.<sup>63</sup>

Despite the indemnity clause practices, the complexity of the State aid rules nevertheless impacts on public authorities, too. Firstly, a decision not to notify *ex ante* about the aid measure carries significant risk to the overall delivery of policy objectives, if it is later found to be incompatible. It also entails political risks for the Government, ministries and other public authorities when assistance has been provided against the State aid rule and repayment with interest is requested. SEs receiving public support bear this financial risk and are often not in a financial position to repay. On the other hand, an overly-cautious approach to the state aid can lead to unnecessary delay in policies being implemented or can prevent policy measures from being fully utilized. It is therefore critical that proper consideration of state aid issues is given to public policy at an early stage of its development, before it is implemented.

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<sup>61</sup> "The Coalition Government and civil society organizations working effectively in partnership for the benefit of communities and citizens in England".

<sup>62</sup> Spear, *Ibid.*

<sup>63</sup> J. Blake: "Could State Funding of Charities Be Unlawful?" *Charities and Social Enterprise Law*, 2008, pp. 8-9.

While the state aid has been indispensable in supporting SE, a body of evidence is emerging, at least in some of the countries concerned, notably, U.K, that **SE** are increasingly **moving away** from the **state aid** as a major source of income. A survey on SE published in 2011, which was commissioned by the Social Enterprise UK and carried on a sample of 8,111 SE, revealed the following pertinent data: 1) **diversification of custom base**. SE are increasingly trading with consumers and with private companies; 2) **turning away from public sector**. The survey reveals that SE are increasingly turning away from public sector markets, in favor of consumers and private companies. This trend merits further explanation. After many notable successes of SE since '90, there has been a mounting expectations among successive governments that SE can spearhead reforms of the UK public services. Indeed, those expectations are highlighted *inter alia* in the 2010 Compact between the Government and NGOs (*supra*). However, the survey suggests that the current economic crises, which brought about significant challenges and uncertainties in public service markets, coupled with the increasing competition by commercial companies and the complexity of the State aid rules with its unintended consequences (*supra*), is undermining SE confidence to operate on those markets and thus is hampering the anticipated social enterprise revolution. While the overall conditions may be ripe for such revolution, many SE are diversifying their activities in order to survive and expend, looking increasingly to the private sector and the general public as partners in social innovation, rather than the central and local governments. SE providing social services are very low on confidence, and a significant number of these are planning redundancies or shifting away from public service markets. In fact, the survey suggests that the main source of income for SE (37%) is in trade with the general public.<sup>64</sup>

"The State Aid rules are now frequently cited, by public authorities, as a possible obstacle to public authority grants, preferential loans and development support, in a way that has caused problems for several high-profile organizations and projects, and a significant degree of uncertainty for others."

*J. Blake: "Could State Funding of Charities Be Unlawful?"  
Charities and Social Enterprise Law, 2008.*

#### **III.1.4. Proposals for Reforms of EU State Aid and Procurement Rules on Services of General Interest.**

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<sup>64</sup> Social Enterprise UK: Fight Back Britain, A report on the State of Social Enterprise Survey, 2011 ([http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Fightback\\_Britain.pdf](http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Fightback_Britain.pdf))

In the line of the foregoing challenges with regard to the implementation of the State aid rules, the European Commission has recently proposed changes in this respect for **services of general interest** - that is, services that public authorities of the Member States classify as being of general interest and therefore are subject to specific public service obligations.<sup>65</sup> While this reform proposal does not pertain to a variety of services in which SE thrive (new and "marginal" services), there is no doubt of their potential impact on SE as well. The term: "services of general interest" covers both: services of general economic interest (SGEI) and social services of general interest (SSGI). The latter are not subject to specific EU legislation and are not covered by the Single Market and the EU competition rules. However, depending on how they are organized, some aspect thereof may be subject to the general EU rules, such as the principle of non-discrimination.<sup>66</sup>

**Services of general economic interest (SGEI):** SGEI are economic activities which deliver "outcomes in the overall public good that would not be supplied (or would be supplied under different conditions in terms of quality, safety, affordability, equal treatment or universal access) by the market without public intervention".<sup>67</sup> There is a **growing trend**, noted by the Commission for those services to be **outsourced** by public authorities at all levels (national, regional and local) to **private actors** (for and not-for-profit).

**Social services of general interest** include social security schemes covering main life risks and a range of other services provided directly to beneficiaries and contributing to social inclusion and cohesion.

Building on its Guide on the implementation of State aid rules on services of general interest,<sup>68</sup> the Commission is now proposing a comprehensive set of action to improve the overall framework for services of general interest, including specific **legal reforms** which will have a **significant impact on SE as service providers**. Those reforms include:

1) **Exemption** of a larger number of social services (regardless of the amount of compensation) from the *ex ante* notification and assessment process by the Commission, provided they fulfill the basic criteria of transparency, sufficient

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<sup>65</sup> Communication for the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions: A Quality Framework for Services of General Interest in Europe, Brussels, COM(2011) 900 final.

<sup>66</sup> Communication., p. 5. The framework for services of general interest is laid down in Article 14 of the Treaty on the Functioning of the European Union (TFEU), and Protocol n° 26 on Services of General Interest. Note also that Article 36 of the Charter of Fundamental Rights the same legal value as the Treaties.

<sup>67</sup> Ibid. p. 7.

<sup>68</sup> EC Guide to the application of the EU rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest, SEC(2010) 1545 final.

definition and compensation. This list now includes, in addition to hospitals and social housing, services of general economic interest meeting social needs as regards health and long term care, childcare, access to and **reintegration** into the **labor market**, and the care and **social inclusion** of **vulnerable** groups.

2) A new **de minimis rule** threshold specifically for **services of general economic interest** up to €500.000 over a three year period. For certain sectors, in particular transport and public broadcasting, special sectoral rules continue to apply.

3) A lighter regime of **public procurement** for services of general economic interest, social and health services, in particular. This includes: higher thresholds; complying only with transparency and equal treatment obligation; and ensuring the quality approach by promoting the use of economically most advantageous tender criteria, as opposed to lowest price, including **environmental and social considerations**.

4) Enabling public authorities to take into consideration as award criteria the **life cycle** of the requested products of services or works.<sup>69</sup>

### III.1.5. Work Integration and State Aid.

Work integration is the **most significant** field of activity for **SE** in all the countries concerned - and, indeed, beyond, which merits further consideration regarding the application of the State aid rules in tis area.<sup>70</sup> In **Italy**, an example of work integration include the so-called "Labour of Public Utility" projects ("*Lavori di Pubblica Utilità*" - LPU), regulated by law and promoted by the Government as an active labour market programme aimed at creating new employment, providing training and supporting social entrepreneurship (type "B"). The LPU targeted specific groups of vulnerable persons, other than those specifically recognized by law: the new comers to the labour market; the long-term unemployed; and, persons hired in the framework of the "job mobility" programmes i.e. programmes established by the local labour office which allowed enterprises hiring unemployed registered on the so-called "mobility list" to be **exempt** from paying social contributions.

In **Spain**, social enterprises type "B" can benefit from direct or indirect subsidies available for employment development programs and the establishment of special employment centers, under the same conditions set out for all private enterprises.

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<sup>69</sup> Communication. *ibid*, pp. 6 and further.

<sup>70</sup> Spear R. & Bidet E., "The Role of Social Enterprise in European Labor Markets," ELEXIES Transversal Report, EMES Working Paper, No. 4 (2001), p. 43. and: Spear R. & Bidet E., Social Enterprise for Work Integration in 12 European Countries: A descriptive Analysis, *Annals of Public and Cooperative Economic*, Vol. 76, No. 2 (2005), p. 36 and further.

Those center primarily target persons with mental disabilities, but also persons with physical, mental and sensorial disabilities. Social enterprises are also eligible for the so called "maintenance aid", which can be obtain in the framework of employment support programs conducted by public authorities. These include grants per job occupied by a disabled worker and allowance from social security contribution and grants to adapt the SE workplace and remove physical barriers to the employment of disabled workers. Those measures may be operational for a maximum of 24 months, irrespective as to whether the worker in question has one or more employment contracts with the same or different organization.<sup>71</sup>

In response to the **economic crisis**, the Royal Decree 1300/2009 introduced **urgent employment** measures for self-employed workers, cooperatives and labor societies, , which include:

- Elimination of the current 24 month term to be able to qualify for unemployment benefits for those employees who become work partners or member of the cooperatives and labor societies.
- Other crises-driven measures, including raising the amount of the total employment benefits, funds for professional education and reduction in social security contribution by companies, cooperatives included, which provide permanent employment positions. Other measures include various actions geared towards improved employability, promotion of entrepreneurship and social economy.

In the **U.K.** the Government is supporting **SE**, including those engaged in work integration, through **community development finance** institutions and the **Community Investment Tax Relief** - and soon through the newly established **Big Society Capital** (*infra*).<sup>72</sup>

In **Slovenia**, the new Law on Social Entrepreneurship, in addition to the so called reserved procurement (*supra*), provides subsidies for SE which seek to employ vulnerable and disabled persons as defined by the Law (enterprise type "B"). Those subsidies pertain to net wages as well as social, health and medical contributions, in line with the Commission Regulation. 800/2008 (bloc exemptions, *supra*). In addition, a SE shall be compensated for the costs incurred for labor trainings of drug and alcoholic addicts, as well as ex-convicts (provided they engage in such program in the first two yeas after serving the term), which is performed based on the agreement with public authority, and which are deemed necessary to perform such a training.

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<sup>71</sup> I. Vidal, N. Claver, The Socio-Economic Performance of Spanish Social Enterprises in the Field of Integration by Work, CIES, p. 6 and further. Spear, Bidet, op.cit. p. 216.

<sup>72</sup> Frequently Asked Questions issued by the Regulator of Community Interest Companies, October 2009. Available at: <http://www.bis.gov.uk/cicregulator/leaflets>

### III.1.6. Other Policy Measures Pertinent to State Aid: The Big Society Capital.

There are other public policy measures geared to financially support SE. One of the most innovative and groundbreaking in this respect is the Big Society Capital (BSC), which was launched by the **U.K. Government** in April 2011. The Big Society is an independent institution, sort of public-private partnership, established to support sustainable social investment market, which will facilitate charities, SE and voluntary organizations ("the social sector") access to capital. It is governed by a social mission and will invest the majority of its surpluses in pursuit of that mission. The BSC provides capital through social investment finance intermediaries i.e. organizations that provide affordable finance to support charities and the social sector. BSC will also seek to achieve financial sustainability over the long term. It is hoped that BSC will have a transformative impact on the social investment market in the UK and will increase awareness of and confidence in social investment by promoting best practice and sharing information; improving links between the social investment and mainstream financial markets; and, working with other investors to embed social impact performance and assessment into the investment

BSC group comprises three entities: the holding company, 'The Big Society Trust', which is a company limited by guarantee with the sole object of protecting the social mission of its operating subsidiary company; 'Big Society Capital Ltd', a private company limited by shares; and a separate entity, the 'Big Society Foundation', which will be constituted to receive charitable donations and develop complementary grant programs to support the Group's mission.

BSC will be financed with equity investment by the Big Society Trust and the four major UK high "street" banks. The equity investment by the Big Society Trust will be funded with the English share of dormant accounts released for social spending through the Dormant Accounts Scheme (which is estimated to total over time up to £400m), which required changes in the pertinent legislation. Proceeds from dormant accounts will be distributed through the Big Lottery Fund.<sup>73</sup>

The Government was recently in talks with the European Commission after fears that its plans to create a social investment bank would breach the EU State aid rules, Following the consultations, the Government announced that a £10m risk capital fund for SE would go ahead.

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<http://www.bigsocietycapital.com/sites/default/files/pdf/BSC%20Vision,%20mission%20and%20activities.pdf>



## III.2. Tax Benefits.

### III.2.1. Introduction.

Public financing of social enterprises may come not only directly, in the form of state aid, but also indirectly, in the form of tax benefits. Originally, Member States - in efforts to circumvent the EU rules on State aid - would resort to various kinds of tax benefits or would relinquish the recipients from duty to pay social contributions (*supra*). To encounter this trend, the EC resorted to a wide interpretation of the prohibition of the state aid, which also includes tax benefits and other indirect forms of support - a position which was reinforced by the European Court of Justice.<sup>74</sup>

None of the countries concerned, save for Slovenia, provides specific tax benefits for **SE**. This is reflective of the fact that SE do not operate in a single institutional form (*supra*, Chapter II), and therefore they are eligible for tax benefits insofar they pertain to specific institutional form in which they operate. In **Slovenia**, however, "social enterprises", as defined by the Law, enjoy **privileged VAT** rates, irrespective of their not-for-profit or for-profit nature (*infra*). As discussed below., tax benefits are primarily afforded to SE operating as NGOs/social cooperatives with the **public benefit status**, but there are some notable exceptions in this respect. For example, the U.K. provides tax relief to investors who back businesses and other enterprises, including SE, in less advantaged areas. In addition, Spain and Italy provide special tax benefits to certain categories of **mutual cooperatives**. However, those benefits are under increasing scrutiny by courts and policy makers. The Italian High Court has recently brought the matter for preliminary hearing before the European Court of Justice, as it took a position that a **favorable tax regime for cooperatives as such** could give rise to violation of Article 87 of the EU Treaty. Also illustrative of this trend are proceedings before the EC, initiated by the Vigilance Body of the European Free Trade Association against Norway. Norway has sought to re-introduce income tax deductions for cooperatives on the part of benefits obtained from transactions with members, which are designated to the social capital. In its preliminary analyses, the Commission stated that specific tax benefits for cooperatives should be considered **by default as state aid**, because of twofold reasons: 1) cooperatives are entities which compete on open market; 2) it is not easy to establish a relation between the favorable tax regime – or some of its measures – and the legal limitations to which cooperatives are subject to regarding the distribution of profits.<sup>75</sup>

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<sup>74</sup> On the other hand, **regulatory privileges which do not impose any direct or indirect burden on state budget are not covered by the state aid prohibition rules** (*Preussen Electra Judgment*, ECJ decision 2001) . M. Blaugerger, Of "Good" and "Bad" Subsidies: European State Aid Control through Soft and Hard Law, West European Politics, Vol. 32. No. 4, 2009, p. 721.

<sup>75</sup>H. Torralvo, M. Rubio: "Privileged Tax Advantage of Cooperatives in the European Union: Reasons and Wrong about Its Questioning"; abstract available at <http://socek.se/node/179>

### III.2.2. Italy

*Income Taxes.* As already discussed, the Italian law does not provide for specific tax benefits for SE, but rather tax benefits afforded to **public benefit organizations** (PBOs) apply accordingly. Grants, donations, and gifts to PBOs are exempt from income tax. The same pertains to income generated from PBO main statutory activities (given that they are not considered an economic activity, *supra*), as well as to income generated from related economic activities, insofar as they do not constitute the prevailing activity of the organization. Income generated from unrelated economic activities is taxed at the same rate set for the commercial companies. Donations and gifts to SE operating as **joint stock** or **limited liability company** would **not qualify** for tax exemptions, since those cannot obtain the public benefit status.

With the exception of membership fees, passive income of a PBO is generally subject to taxes. Membership fees are tax exempt insofar as they do not amount to consideration for services provided by the organization - in which case they would be deemed an economic activity and taxed accordingly. Return to investment in trust is generally taxed at a 12,5% rate, while dividends are taxed at a 5% rate. A withholding tax of 12.5% is levied on capital gains resulting from a PBO's sale of an "insignificant" shareholding (i.e. the one which does not exceed 20% of the share capital of a non-listed company, or which does not exceed 2% of the share capital of a listed company). Otherwise, a PBO is subject to 40% general income tax rate on capital gains.

*Donations.* Tax deductions are provided for individual and corporate donations in cash, up to €2,065.83 or up to 2% of their taxable income, whichever the amount is higher. In addition, tax credits are provided for individual donations (both in cash and in-kind), up to €1,032.91.

*Real Estate.* The real estate which a PBO uses to pursue its main statutory purposes is exempt from taxes. However, this exemption seems to apply only to PBOs engaged in humanitarian, health, teaching, culture, and religious activities. The transfer of real estate is tax-free for a seller, while a buyer is subject to VAT or registration fees.

*VAT.* PBOs are exempt from VAT on goods and services they provide in the course of their main statutory activities, as well as on goods and service they provide in the pursuit of their related economic activities. This presumably means that they cannot claim a refund on the purchase of inputs in goods and services they provide,

because they are not part of the VAT system. PBOs are exempt from VAT with regard to the purchase of certain kinds of goods (e.g. ambulances).

*Other Tax Benefits.* The tax regime for **social cooperatives** merits further consideration. As a general rule, social cooperatives do not enjoy tax benefits otherwise provided for cooperatives, given that they are not mutual (member) benefit organization (*supra*) - hence the incentive for them to apply for the **public benefit status**. Nevertheless, there are some benefits specifically ascribed to social cooperatives within the general tax framework for cooperatives. First, taxes are not levied on income which they allocate to the compulsory reserve fund. In addition, services provided by social cooperatives are exempt from VAT, or are taxed at the reduced 4% rate, in case they choose to register with the VAT. It seems that the reduced VAT rate rule applies irrespective of whether a social cooperative is granted the public benefit status. Depending on the circumstances, it may benefit from registering with the VAT and charge a reduced 4% rate, as it would allow it to reclaim VAT it has paid on its inputs in goods and services it provides. The VAT reduced rate reflects the fact that, unlike other PBOs, social cooperatives do not have any restraints in engaging in economic activities.

### III.2.3. Spain

*Income Taxes.* Grants and gifts to public benefit organizations (PBOs) are exempt from income tax. The same pertains to income generated from PBOs main statutory activities, which are not considered economic activities. Income generated from PBO's related economic activities is exempt, insofar as profit from such activities does not exceed 20% of the PBO's total annual income. Income generated from unrelated economic activities is taxed at a reduced corporate rate of 10%.

*Donations.* Corporations can deduct as tax credit 35% of the value of its donations, up to 10% of its taxable income base, or 0.1% of its turnover, whichever the amount is higher. An individual can deduct as tax credit 25% of the value of his donation to PBO (cash or in-kind) up to 10% of his gross taxable income.

*Property Taxes.* PBOs are exempt from property taxes levied on real estate they use for their main statutory purposes. In addition, they are exempt from the transfer of property taxes.

*VAT.* PBOs are generally exempt from VAT, unless they engage in economic activities and register with the VAT system. Other than that, they are treated as final consumers and are not entitled to VAT refunds.

*Other Tax Benefits.* PBOs are exempt from capital gains taxes.

*Specially tax protected cooperatives.* A number of (mutual benefit) cooperatives enjoy privileged tax status ("*especialmente protegidas*"). Those include worker cooperatives; agricultural cooperatives; consumer cooperatives, etc. They are subject to lower income tax. In addition, they enjoy preferential treatment with regard to the amortization of their equipment.

### III.2.4. Slovenia

*Income Taxes.* Public benefit organizations (i.e. associations, foundations and private institutes pursuing public benefit activities) enjoy tax exemption on most of their income: grants, donations, gifts, membership fees, and income generated in the course of carrying out public services. However, taxes are levied on income generated from economic activities. An activity is deemed an economic activity if at least one of the following conditions are fulfilled: 1) the activity is performed on the market with the goal of generating profit; or 2) by engaging in the activity, the organization competes on the market with other taxpayers. Passive income (dividends, lease fees) is also considered income from economic activities.

*Donations.* Corporations may deduct up to 0.3% of their taxable income for the public benefit purposes, and additional 0.2% of taxable income for cultural purposes or to an organization established for the protection from natural and other disasters. Individuals can dedicate up to 0.5% of their taxable income to public benefit purposes.

*VAT.* The following goods and services are exempt from VAT: (1) activities of public interest carried by public institutions or public benefit organizations (hospital and medical care, social services, youth care, vocational training and nursery, goods and services generated from occasional fund raising events, etc), provided the supply of goods and services is essential to the transaction exempted; cannot otherwise be carried out; and does not give rise to the issue of distorted competition. The forgoing transactions are tax exempt if carried by **public benefit organizations**, provided the following additional conditions are: (a) they are established for not-for-profit purposes and do not distribute any profit; (b) the organization is managed mostly on a voluntary basis by individuals who do not have direct or implicit interest in those transactions; (c) the organization charges prices approved by the public authorities, or, if approval is not needed, charges prices no higher than those approved and no lower than prices charged by taxable persons; and (d) it is not likely that the exemption would give rise to the issue of distorted competition. (2) import of certain goods (humanitarian gifts to public authorities and public benefit organizations; goods imported by those organizations to support the needy in case of environmental disasters, goods necessary for education, training and employment of disabled persons, etc.

In addition, on the purchase of goods which "**social enterprise**" uses for public benefit purposes, a privileged 8,5% VAT rate is levied.

*Other Tax Benefits.* PBOs are exempt from inheritance and gift taxes, but not necessarily from VAT taxes on donated gift.

### III.2. 5. United Kingdom

No particular tax benefits are afforded to the **Community Interest Company** (CIC) to offset the disadvantages of CIC as compared to a regular company (caps on the director's salary and shareholder dividends (*supra* Chapter II), but rather tax benefits are only provided for charities (public benefit organizations).

*Income Taxes.* Charities are exempt from most forms of direct taxation: grants (including those from foreign sources, donations from individuals and corporations and similar sources of income. Membership fees are exempt if they are essentially donations, rather than consideration for services rendered, in which case they can be deemed trading activity and potentially taxed. The profits of "primary purpose trading" (i.e. trading which occurs in the course of actually carrying out a primary purpose of the charity) are exempt from tax (but may be subject to VAT, *infra*), provided that profits are applied solely to the purposes of a charity. If a charity engages in economic activities through a subsidiary company, profits of the latter which a charity uses to further its statutory purposes is tax exempt. Charities do not pay tax on investment income.

*Donations.* Donations of cash by individuals to charities qualify for tax relief under the so-called "Gift Aid" scheme. Under this scheme, a charity can reclaim the basic rate tax that a donor has paid on the income from which the gift was made. For example, if a charity receives £300, this is treated as having been made out of £400 income from which a donor has already paid £100 in tax. A charity can claim £100 from the Inland Revenue. In addition, a donor who is higher-rate taxpayer can claim back higher-rate relief from the Inland Revenue, reducing the net cost of making the gift. Each donor must complete a simple Gift Aid Certificate, which can cover a series of donations, except in the case of small donations of £10 or under up to a maximum of £5000 per charity per year.

Donations by corporations to charities under the Gift Aid Scheme operate in a different way. Gift Aid donations made by corporations are paid gross so no tax is repayable to the charity, but for tax purposes the amount paid by the corporation can be set against its profits. Donations of shares, land and buildings also benefit from tax relief. In addition, some charitable giving by businesses (for example, sponsorship payments) can be treated as allowable expenses of the business (if

made wholly and exclusively for the purposes of the trade) and deducted when computing profits of the business for tax purposes.<sup>76</sup>

Property Taxes. Charities are entitled to 80% reduction of business rates (the local property tax). Local authorities have a discretion to grant further 20% relief. Non-charitable NGOs can receive partial or total exemption from property taxes, at the discretion of local authorities.

VAT. The VAT is required to be collected by entities, including NGOs, whose turnover exceeds £77,000 in a given year. Certain transactions are exempt from VAT, including most grants. Certain goods and services are zero rated, including those donated to charity for sale or export and medical and scientific equipment for use in medical research and treatment. Grants, including grants from foreign donors, are not ordinarily subject to the VAT. The VAT tax regime might apply, however, if the donation is paid to subsidize a trading activity of an NGO, or if the donation is conditioned on benefits to the donor or a third party. In addition, certain goods and services are zero-rated for charities, including: goods donated for sale or export; advertisements to raise funds or to publicize the name of the charity; medical and scientific equipment for use in medical research and treatment; certain equipment and building alterations for people with disabilities; construction of new buildings for certain charitable purposes, including residential accommodation and community buildings; and one-time fundraising event.<sup>77</sup>

Other Tax Benefits. Charities are exempt from paying Stamp Duty and Stamp Duty Land Tax on the transfer of assets, including shares and land; Inheritance Tax on legacies and bequests; and Capital Gains Tax.

### III.2.6. Austria

Income Taxes: Public benefit organizations (associations and non-profit limited liability company) are exempted from most of its income: donations, gifts, membership fees (insofar as they do not amount to economic activities). Income generated from economic activities is exempt provided the following conditions are met: (1) the underlying goal of that activities is to support public benefit purposes; (2) those activities are necessary to pursue the underlying (public benefit) goal of the organization; (3) they do not give rise to the issue of distorted competition.

Donations. Corporation and individuals may deduct up to 10% of their taxable income to public benefit purposes.

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<sup>76</sup> Country note on England and Wales, USIG ([www.usig.org](http://www.usig.org))

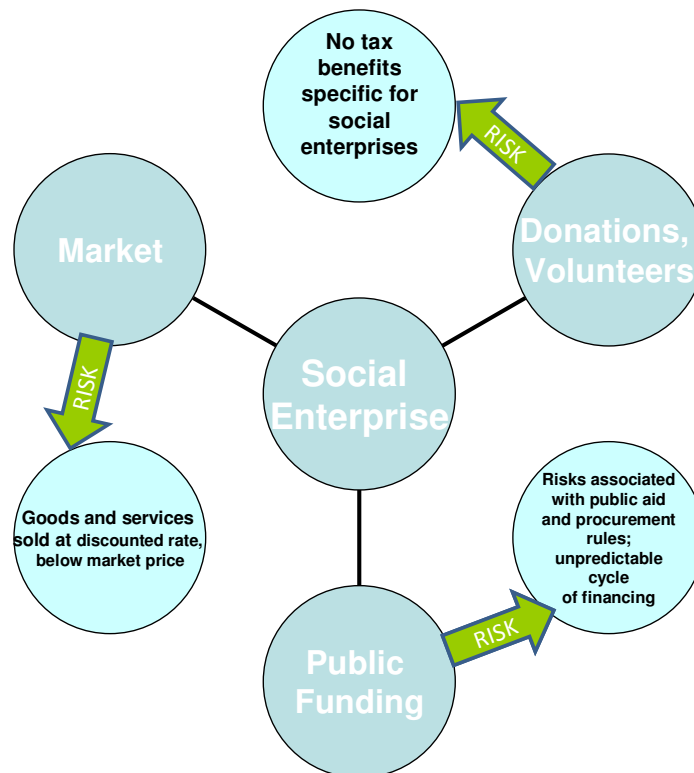
<sup>77</sup> Ibid.

Property tax: PBOs are exempt from real property taxes insofar as they are used to pursue their public benefit and charitable purposes.<sup>78</sup>

VAT: The VAT exemptions depend on the activity rather than the legal form of an organization, and pertain to health services and charitable work.

Based on the foregoing analyses of the state aid rules and tax rules, the following sources of income for SE and the risks associated with that income are identified, as presented below.

### SOURCES OF INCOME FOR SE AND PERCEIVED RISKS<sup>79</sup>



<sup>78</sup> The law is available at: <http://investment-portal.net/austria/gesetzat/Grundsteuergesetz.html>

<sup>79</sup> Developed by Dragan Golubović.

**TAX BENEFITS MAY ALSO FALL UNDER THE STATE AID RULES.**

**OTHER INSTITUTIONAL SUPPORT FOR SE WHICH DOES NOT HAVE DIRECT OR INDIRECT IMPLICATIONS ON THE BUDGET DOES NOT AMOUNT TO STATE AID.**

### III.3. Other Policy Measures Pertinent to SE.

In addition to policy measures geared to improve the financial sustainability of SE, there are other policy measures aiming to facilitate the establishment and operation of SE, which are not necessarily financial, and which can be summarized as follows:

**1) Facilitating the establishment and operations of SE.** For example, **Spain** has expanded the network of the "Points of Access and Start of Procedures" to facilitate the administrative requirement for setting up new companies and strengthen the consultancy services to the disadvantaged, including young people and women, who plan to set up a **SE**. In addition, it has expanded the network of "**Advice and Paperwork Points**" by over 100 offices at which an application for establishing all types of limited liability companies, SE included, can be processed on-line. The Government is planning to introduce legislation to establish common on-line register for companies and expand the electronic data interchange system between government departments and private companies. In collaboration with the Spanish Chambers of Commerce and Industry, which is the representative business association (*infra*), the government has carried out the "**Single Windows for Businesses**" project to provide integrated services to SE and other SMEs. In Slovenia the new Law on Social Entrepreneurship (Law) envisages "business incubators" to facilitate the establishments and operations of SE.

**2) Data gathering.** In some countries (Italy, Spain) there is a special registry (or in case of Spain, a 'catalogue') of SE, which facilitates data collection for statistical purposes, and which is critical for the assessment of the pertinent policy measures in place. The Spanish Law on Social Economy (Law) obliges the Government to establish the system of gathering of data pertinent to social economy,

**3) Facilitating a structured policy dialogue with SE.** For example, the Spanish Law envisages setting up the Council for the Promotion of Social Economy, as the Government's inter-sector advisory body on issues pertinent to social economy, which is composed of the central and regional government representatives, representatives of SE, and cross-sectoral confederations.



**4) Developing policy documents.** This is reflected, for example, in the Slovenian Law, which obliges the Government to adopt a strategy for the development of social entrepreneurship every four years, and an action plan of implementation thereof. In the U.K. the Compact on the relationship between the government and voluntary sector also envisages a monitoring mechanism for implementation.

**5) Ensuring quality control.** This is reflected in the Italian Law on Social Enterprises which envisages setting up a mechanism to monitor and support the quality work of SE with the Ministry of Labor and Social Affairs. The Spanish Law obliges the Government to submit a report on the implementation of the Law to Parliament (Congress of Deputies) within two years after its coming into force.

### III. 4. Institutional Support of SE and SE Networking

In all the countries concerned there are public institutions responsible for supporting SE and implementing pertinent laws and public documents in place. In **Italy, Spain, Slovenia, and Austria**, ministries responsible for labor and social affairs and their regional and local counterparts play particularly prominent role in this respect. This is reflective of the **critical role** SE play in **work integration** (*supra*). In Italy, there is also the **Agency for the Third Sector**, which has the power to propose legislation pertinent to NGOs and monitors pertinent data. The **Spanish** Law is particularly elaborate with regard to the obligation of the state authorities relating to social economy. The focal institutional point is the **Directorate General for the Promotion of Social Economy and the European Social Fund** (Directorate), which operates as a separate division of the Ministry of Labor and Social Affairs' Secretariat-General for Employment. The duties of the Directorate include: co-ordination of the government's agencies and departments engaged in the promotion of social economy; formalizing accords and agreements on social economy with the autonomous regions and national public institutions, including the National Public Employment Service; and, facilitating the funding of SE. The Law introduces general obligation of the public authority to work on removing the perceived barriers for social economy development, including the simplification of administrative requirements; facilitate initiatives aimed to promote social economy; promote the principles and values of social economy; promote trainings and facilitate access of SE to technological and organization innovations; involve SE in active employment policies, especially with regard to the vulnerable groups; an introduce references to the social economy in the curricula of education institutions.

In **U.K.** in 2010, following general elections, the Office of the Third Sector was renamed to the **Office of Civil Society**. The Office works across government departments to translate the *Big Society Agenda* into practical policies and has a

separate team for social investment and SE.<sup>80</sup> The focus of the Office is on creating conditions to make it easier to run a charity, a SE or a voluntary organization; getting more resources into the sector; strengthening its independence and resilience; and, making it easier for sector organizations to work with the state.<sup>81</sup>

In all the countries concerned various forms of social enterprises have established **network and umbrella organizations**, which serve twofold role: 1) they allow SE to advocate for their interests more effectively and to partner with governments in a structured dialogue on policy measures pertinent to social economy; 2) they also facilitate the implementation of those policy measures geared towards providing support to social economy.

**In Italy**, *Conorzio Gino Mattarelli (CGM)* is a national platform of social co-operatives, which was established in 1986. It consists of 70 provincial consortia representing 850 social co-operatives with 21,000 active members. There is a separate national federation of social co-operatives, *Federsolidarieta*, which is affiliated with the Catholic Church. The primary purpose of CGM is to provide research and training for local consortia managers. CGM also acts as national-level contractor for the provision of services to be provided jointly by various consortia and co-operatives. There are about 70 provincial consortia, most of them operating in Northern Italy. They provide a range of services for their members, including trainings on the accountancy rules, management, marketing, preparing joint tender documentation and fundraising for bigger projects. They also perform a role of strategic advisor and agent in supporting social co-operatives contracting out municipality services. In many instances, the provincial consortia will act as a contractor, sub-contracting operations to the consortia members. The activities of such consortia - as well the economic activities of SE umbrella organizations - are becoming **increasingly scrutinized by the EU**, because of concerns that they are distorting competition.

In addition, there are local consortia, such as *Sistema Imprese Sociali – SIS*, which operates in the city of Milan. SIS provides technical and other support to its members, and facilitates the establishment of new social co-ops in Milan. Local, provincial and national consortia thus play two important functions. First, they enable their members to gain and take advantage of skills which they cannot afford

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<sup>80</sup> The Big Society Agenda is composed of several components: *community empowerment*: transferring power away from central government to local communities; *opening up public services reforms*: enabling charities, social enterprises, private companies and employee-owned co-operatives to compete to offer people high quality services, including those relating to work integration; and, **social action**: encouraging and enabling people to play a more active part in society. National Citizen Service, Community Organizers and Community First will encourage people to get involved in their communities. <http://www.cabinetoffice.gov.uk/content/big-society-overview>

<sup>81</sup> <http://www.cabinetoffice.gov.uk/resource-library/office-civil-society-structure-finalised>

to gain otherwise. Secondly, they provide their members with economies of scale which could otherwise be achieved only by embracing pro-business stand in management and finances, at the expense of the underlying principles governing co-operatives, including the democratic governance (*supra*, Chapter II.). Among others, the consortia assists their members in securing preferential lending terms with banks, act as guarantor for the loans taken by their members, and provide other kind of financial and other assistance as needed.<sup>82</sup>

In **Spain**, the Spanish Business Confederation of Social Economy (*Confederación Empresarial Española de la Economía Social* - CEPES), composed of 24 member organizations, provides a platform for dialogue between SE and public authorities. CEPES has been contributing actively to the shaping of Government policies and initiatives at the local, regional and national levels with regard to the employment, social inclusion, empowerment and development of SE, corporate social responsibility (CSR) and development of de-industrialized areas. It has also been collaborating with the National Public Employment Service on the design and execution of employment and vocational training plans. In addition, CEPES represents the Spanish social economy enterprises in European forums, and coordinates the "Mediterranean Euro Network of the Social Economy", which covers Spain, Greece, Italy, France and Portugal. Other representative organizations include the Spanish Association of Foundations, representing the interests of the Spanish foundations; the Spanish Federation of Social Insertion Companies; and the Association FEAPS for the Employment of Disabled People. These platforms advocate for the interests of their members and partner with the national, regional and local governments on public policies impacting on their members

In the **United Kingdom**, most SE are represented by the *Social Enterprise Coalition* (SEC), which represents more than 240 national umbrella bodies of SE, 46 regional and national networks of SE, and 10 000 SE which operate in more than one region in the UK. SEC provides a national platform for SE to voice their needs and discuss with the government on SE issues. It also helps raise the profile of SE.

In **Austria**, there is federal umbrella organization, bringing together all SE in Austria (*Bundesdachverband für soziale Unternehmen* - BDV).

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<sup>82</sup> P. Gosling: "Social co-operatives in Italy: Lessons for the UK", SEL, 2002, pp. 10-11.

#### IV. SUMMARY OF MAJOR FINDINGS: WHAT LEGISLATORS AND POLICY MAKERS NEED TO KNOW ABOUT THE LEGAL REGIME FOR SE?

**1. One solution does not fit all.** Each country has to develop its **own** legal framework for social economy and social enterprises. International standards, guidelines and principles, **comparative reports**, and best practices may serve as **sources of inspiration**, however, it is not possible to simply copy-paste a particular SE model.

**2. There is no one ideal legal form for SE.** The legal framework for SE in all the countries surveyed is primarily concerned with the **nature** of the organizations' goals and **activities**, rather than with the **institutional forms** in which they operate. This pertains to countries which do not have a distinct institutional form for a SE (Italy, Spain, Slovenia, and Austria) as well as to the U.K., which does. In the case of the latter, it is reflected in the fact that most SE operate as charities, rather than as community interest companies (*infra*, Annex I). This is consistent with the **general requirements** for an enabling legal framework for SE, which include a **choice** between different models or legal patterns, and **autonomy** of SE to adjust their respective statutes (by-law) in a fashion which would cater to their needs in pursuing their social mission.

**3. Adverse impact of exceptions to the general rules.** There is a number of noticeable **departures** from the general **guiding** principles of SE (as defined in Chapter I.4.) in the countries concerned, and in particular with the SE **cooperative structure** in Italy and Spain. Examples include:

- Organizations with an internal democratic structure characterised by the rule “one member – one vote”, **however**, plural voting.
- Equal rights and obligations of all members, **however**, admission of different categories of members.
- Identity of owners and users as a matter of principle, **however**, deviations including external directors, external investors or investor-members or non-using members and business with non-members .
- Indivisible reserves, **however**, special reserves to which departing members have a claim or which may be distributed to individuals after liquidation.

- Distribution of surplus in proportion to business done by the member with the common enterprise (patronage refund), **however**, dividend on paid-up share capital.<sup>83</sup>

Those departures weaken the prescribed legal regime for SE and give rise to greater transactional costs in the implementation thereof. Like any other regime, the legal regime for SE must be sufficiently flexible, but at the same time precise and transparent, in order to ensure its fair and consistent implementation - and keep the transactional costs in check.

**4. There is a difference between SE and NGOs.** The defining characteristics of social enterprises in all the countries surveyed are **not-for-profit goals** (or limited distribution of profits) and **regular trade of goods and service** in order to further those goals. Advocacy and fund raising organizations, among others, are therefore not deemed SE. Because of those features, the third (not-for-profit) sector plays a key role in the development of social economy in the countries surveyed, although in the case of Italy and Spain, the situation is more balanced, due to the role of social and mutual cooperatives. However, the concept of SE and non-governmental, not-for-profit organizations (NGOs) do not entirely overlap, which is one of the reasons why distinct legislation for SE may be needed. According to the John Hopkins Comparative Non-Profit Sector Project, the major features of NGOs include: institutionalised/legal structure; private entities (structural independence from the government); self-governing/autonomous entities; not-for-profit goal and profit distribution constraint; and voluntarism (voluntary contribution of time/money) - but not the **regular provision** of goods and services in the market. In addition, SE may entail mutual cooperatives, as well as other forms which allow for a limited distribution of profits among members. Therefore, there might be a need for a **distinct legislation** for SE, which will be **reflective** of those differences.

**5. SE reach beyond work integration/social inclusion.** With regard to the legitimate (not-for-profit) goals of SE, while **social inclusion** and **work integration** feature prominently in all of the countries surveyed, they also embraced a broader concept of social economy, the only notably exception being Austria. The social economy goals largely overlap with the legitimate goals of public benefit organizations (charities), thus blurring the line between SE and PBOs, in particular those engaged in regular trade of goods and services. This is particularly true in case of Italy and the U.K.

**6. The role of the framework regulation for SE should be clear.** Three of the countries surveyed (Italy, Spain and Slovenia) have introduced the framework

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<sup>83</sup> Munkner H. H, Five theses illustrating the interdependence of the different elements constituting a favorable climate for legislation adjusted to the needs of enterprises with social objectives, Paper presented at the meeting on the Role of Non-Governmental Organizations in the Social Economy, Bucharest, June 26, 2006, p. 2.

regulation for SE. While it is premature to assess the full impact of those regulations on social economy/SE, there are some notable similarities between the framework regulation in Italy and Spain in that **neither** of them provide additional **public and tax** benefits for SE. Rather, the **underlying** benefits of a framework regulation on social economy/SE have to do with spelling out their defining characteristics, the guiding principles and the field of activities, in order to give the concept more clarity; creating the **legal basis** for a comprehensive set of **measures and policies** supporting SE.; specifying general obligations of the government towards furthering social economy; outlining policy measures necessary to nurture the social economy; and setting up a mechanism for representation and cross-sectoral cooperation in a structured dialogue with the government on issues pertinent to social economy/SE.

**7. There is a risk of providing specific benefits for SE in a framework regulation.** Slovenia stands out as the only country surveyed where the new framework regulation for SE sets out **specific benefits** (in the forms of subsidies and taxes). This seems a risky approach, as it gives the framework regulation the status of *lex specialis* in relation to laws which otherwise control subsidies and tax issues, which might create problems in the **implementation** of those benefits, in particular given the complex criteria definition of SE set out in the Law.

**8. Be mindful of how you define SE.** Setting out the defining characteristics and the guiding principles of a SE in the framework regulation might bring some clarity to the concept. However, it is **not risks-free**, as it might prove difficult to accommodate all of them in practice. For example, the Spanish and the Slovenian law envisage *inter alia* **democratic** governance (one member-one vote) as a distinct feature of a SE. However, it is not certain how a foundation, and in the case of Slovenia private institute as well, can meet the democratic governance criteria, given that they are **non-membership** organization. The same pertains to the growing trend of **cooperatives** extending the **voting** rights to **outside** investors (*supra*, Chapter II). The **legal** ramifications of this discrepancy for non-membership organizations do not seem **clear**, but it would seem that they **fall out** of the remit of the statutory definition of a SE outright. This gives rise to the issue of their eligibility for the SE benefits set out in the Law, despite the fact that they are practicing SE. Insofar as there is the perceived need to define a SE by law, the “**minimal common denominator**” approach (not-for-profit goals, or limited distribution of profits, and regular sale of goods and services), is better suited to avoid the foregoing difficulties in attempting to legislate the “ideal type” of social enterprise (*supra*, Chapter I).

**9. The regime for public financing of SE is improving.** Public financing plays a critical role for SE. While the current EU State Aid and procurement rules are seen as **complex** and proving burdensome, sometimes preventing Member States to fully benefit from policies intended to foster SE, there are some **positive** developments in this respect. First, insofar as public financing is subject to the State aid rule, the

proposed increase in the **de minimis** rule threshold (from 200,000 Euro over three years to 500,000 Euro) for services of general economic interest creates new opportunities for SE. The same pertains to the proposal **to exempt** from **ex ante** notification a large number of services relevant to SE. The innovative practice of public-private partnership in this respect (e.g. the **Big Society Capital** in the U.K.) suggests that even the current EU framework for the state aid provides **enough room** for such practices not to run afoul the principles underpinning the Single Market.

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## ANNEX I - SOCIAL ENTERPRISES: ECONOMIC IMPACT

### ITALY

Number of SE	235,232
Annual income	38 billion Euros
Number of employees	630,000 workers
Number of volunteers	3,3 million
Participation in social services provided	70-80%

### SPAIN

Number of SE	44,693
Number of employees	2,377.000
Number of business affiliates with SE	12, 150.000
Percentage of SE employing 11-49 workers	97%

#### SPAIN: *Mondragón Corporacion Cooperativa (MCC)*

Number of employees	83,569
Annual income	cc 15 billion Euros.
Total assets	cc 21 billion Euros.

### SLOVENIA

Number of SE	156 (operating as commercial companies)
Number of workers	13,580.

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<b>Number of disabled workers</b>	<b>6,348.</b>
<b>Annual income</b>	<b>No statistical data</b>

**UNITED KINGDOM**

<b>Number of SE</b>	<b>68,000</b>
<b>Number of SE operating as CIC</b>	<b>6394</b>
<b>Number of charities (including those regarding themselves as SE)</b>	<b>162,098</b>
<b>Number of employees in SE</b>	<b>800,000</b>
<b>Annual income</b>	<b>£24 billion</b>

**AUSTRIA**

<b>Number of SE</b>	<b>179</b>
<b>Annual income</b>	<b>36 million Euro</b>
<b>Number of employees</b>	<b>900</b>
<b>Number of volunteers in social service organizations</b>	<b>151,000</b>

**ANNEX II - SOCIAL ENTERPRISES: LEGAL FORMS**

ITALY	SPAIN	SLOVENIA	UK	AUSTRIA
Association.	Association.	Association.	Community Interest Company.	Association.
Foundation.	Foundation.	Foundation.	Industrial and providential societies.	Not-for-profit company.
Social co-op.	Co-operative (mutual and social).	Private institute.	Charitable incorporated organization.	Labor insertion company.
Not-for-profit company.	Labor Insertion company.	Labor insertion company.		

### ANNEX III - EU LEGISLATION/DOCUMENTS PERTINENT TO STATE AID AND PROCUREMENT

Legislation/Documents	Subject Matter
Articles 87, 88, 93 of the EU Treaty (Article 107, 108, 109 of the TFEU).	Prohibition of unfair competition; justifiable exception re. State aid rules.
EC Regulation (EC), 994/98.	Aid to SME.
Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty.	Rules for application of Article 93 of the EC Treaty.
EC Regulation, 70/2001.	Aid to SME.
EC Regulation, 68/2001 on the application of Articles 87 and 88 of the EC Treaty to training aid.	Lawful State aid to training.
EC Regulation, 2204/2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment.	Lawful State aid for employment.
EC Regulation No. 364/2004.	State aid for research and development
EC Regulation, 1628/2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid.	Lawful State aid to regional investment.
EC Regulation, 1998/2006.	De minimis rule.
EC General Block Exemption Regulation 800/2008.	Block exemptions from State aid rules.
EC Interpretative Communication COM(2001) 566.	Application of social criteria in public procurements.
Community Guidelines on State aid to	Interpretation of State aid rules to

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Research and Development and  
Innovation (OJ C 323/2006).

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development and innovation.

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rules on state aid, public procurement  
and the internal market to services of  
general economic interest, and in  
particular to social services of general  
interest, SEC(2010) 1545 final.

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on general interest.

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