Legal Regulation of Economic Activities of Civil Society Organizations

Policy paper

European Center for Not-for-Profit Law
Legal Regulation of Economic Activities of Civil Society Organizations

Policy paper

The paper was prepared by European Center for Not-for-Profit Law (ECNL) on demand of the Legal Transformation Center and Assembly of Pro-Democratic NGOs of Belarus. The European Center for Not-for-Profit Law is a leading European resource and research center in the field of civil society law, based in Budapest. It aims to promote an enabling legal and fiscal environment for civil society in Europe and convey European experiences to other parts of the world.

Copyright ECNL© 2015 All rights reserved
Table of Contents

1. Introduction .................................................................................................................................................... 3
2. Definition of Economic Activities vs. Commercial Activities ................................................................. 5
3. Regulatory Models ........................................................................................................................................... 7

   3.1. European Regulatory Models of the Permissibility of CSOs’ Engagement in Economic Activities .............................................................................................................................. 7
   3.2. Regulatory Models of Taxation of CSO’s Income from Economic Activities ...................................... 13
4. Other Related Issues ...................................................................................................................................... 16

   4.1. Social Enterprises ...................................................................................................................................... 16
   4.2. Legal regulation of passive investments ................................................................................................ 18
5. Conclusions and Lessons Learned ............................................................................................................. 19
1. Introduction

Economic activities are one of the key income sources of the civil society organizations (CSOs).¹ They play critical role in the CSOs’ efforts to diversify their funding and help them to secure their financial sustainability. Allowing CSOs to generate income can improve the effectiveness, quality and diversity of services they provide for the benefit of public. Through economic activities CSOs can access additional funding and also raise expectations of beneficiaries for the services they paid for.

The permissibility of CSOs’ economic activities was endorsed by various international instruments, including the Council of Europe Recommendation on the legal status of NGOs in Europe. Specifically, Section 14 of this Recommendation stipulates that: “NGOs should be free to engage in any lawful economic, business or commercial activities in order to support their not-for-profit activities without any special authorization being required, but subject to any licensing or regulatory requirements generally applicable to the activities concerned.”² Furthermore, UN Special Rapporteur on the Rights to Freedom of Peaceful Assembly and of Association, Maina Kiai, emphasized in one of his thematic reports that “the ability to seek, secure and use resources is essential to the existence and effective operations of any association, no matter how small.”³

Also, according to Article 190 of the OSCE/OIDHR Joint Guidelines on Freedom of Association recently adopted by the Venice Commission at its 101th Plenary Session, “In order to pursue their objectives, associations should be able to both generate income from their activities and to seek it from public and private sources within and beyond the state in which they are established. It is important for this purpose that associations are able to approach the widest range of possible donors. The income can be in the form of cash, other forms of financial instruments, proceeds from the sale of property and goods or equipment belonging to the association, as well as in the form of other benefits attributed

---

¹ The term civil society organizations (CSOs) is understood to encompass the narrow definition of civil society which relies on the following criteria: 1) it is voluntarily organization established by a private instrument (contract, act on establishment), rather than by law; 3) it may be a membership or non-membership; 4) it is not part of the government structure; 5) it is established to pursue public or mutual benefit goals; 6) it is not-for-profit. Therefore, the term includes associations, foundations, private institutions, centers, not-for-profit corporations, and any other organization falling under the above criteria. The experts recognize the existence of other forms of CSOs (e.g., political parties, religious organizations, trade unions) but for the purposes of this Report, the focus is only on organizations under the narrow definition.

² Council of Europe: Recommendation CM/Rec (2007)14 of the Committee of Ministers to member states on the legal status of non-governmental organizations in Europe.

to an association (for example, income from investments, rent, royalties, economic activities and property transactions).”

Civil society organizations are by their nature non-profit legal entities. However, this does not mean that they should not be allowed to pursue any economic activities if they abide by the general principles of non-profit operation including the principle of non-distribution. Following are three core principles characterizing non-profit organizations that help to distinguish them from for-profit legal entities:

A. **Primary purpose is non-profit.** Non-profit entities shall be organized and operate primarily without the aim to gain profit. Generating some profit is not prohibited as long as the organization’s primary purpose is not for profit.

B. **The principle of non-distribution.** Non-distribution constraint is the core principle governing non-profit organizations. This principle prevents non-profit legal entities from distributing profits to owners, members, officers, directors, agents, employees and other private parties that may directly or indirectly exercise control over the organization.

C. **The organization’s characteristics are determinative of NPO’s status.** When determining whether a legal entity is non-profit, it is essential to examine the organization’s activities and purposes and not just its legal form.

The present paper focuses on the European regulatory approaches towards two main issues pertinent to economic activities: (1) permissibility of the direct economic activities of CSOs and consequently (2) the taxation of the income from the economic activities. The paper also defines the term “economic activity” and explain the conceptual distinction between the commercial/business/entrepreneurial and economic activities used by several European jurisdictions. Last but not least, we briefly introduce other related issues, such as social entrepreneurship and passive investment. In the end of the paper we provide a set of conclusions extracted from the European practices presented herein.

---

4 Available at: http://www.osce.org/odihr/132371
2. Definition of Economic Activities vs. Commercial Activities

“Economic” activity could be generally defined as *active sale of goods or services that is pursued with the frequency or continuity*. This is for example active sale of T-shirts, CDs, books or other goods by the organization. In terms of provision of services it could be running an orphanage or house for elderly people but also distribution of food or provision of educational services.

Based on the comparative practices various activities are traditionally excluded from the general understanding of the notion of economic activities. Income from the purely gratuitous gifts, grants, donations, contributions and net revenues from passive investment are traditionally excluded from this definition. Occasional or irregular sale of goods and services that does not create any competition to the for profit entities is also excluded from this definition. This could be for example occasional lotteries, raffles or fundraising sport or cultural events. Also, fees that are directly connected to the public benefit purpose of the organization, such as admission fees to the museums or patient fees for non-profit hospitals are excluded from the scope of economic activities.

There are, however, some countries that make a conceptual distinction between the term “economic activities” and “commercial/business/entrepreneurial activities”, treating economic activities more permissively. The laws in these countries distinguish between economic activities that are related to statutory purposes and commercial/business/entrepreneurial activities unrelated to the CSO’s statutory purposes and creating competition in the for-profit sector.

For example in Hungary, *economic-entrepreneurial activity* is defined as an economic activity that is carried out businesslike and aims at or results in the acquisition of income or property, except for accepting donation and the mission-related and public benefit activities that result in income.\(^5\) Similarly, in Germany, *economic activities* necessary to pursue statutory purposes of the CSO are fully tax exempt, whereas *commercial activities* considered as unnecessary to pursue the statutory purposes are above certain threshold taxed at the full rate.\(^6\)

As a conclusion, some countries have different understanding of the scope of economic and other business/commercial/entrepreneurial activities. However, drawing the line between them might be sometimes slippery and confusing, particularly due to the diversity of the country regulations. Therefore this paper simply employs the term “economic activity” and use other terminology only in case the specific country analyzed clearly applies the distinction.

---

\(^5\) Act CLXXV of 2011 Section 2 11.

Economic activities may be carried out **directly** by the civil society organization itself or **indirectly** by creating an affiliated commercial organization. In the second case, the affiliated organization transfers profit generated from the economic activities to the CSO which shall use these funds for the achievement of its statutory goals.
3. Regulatory Models

The present chapter gives an overview of the European regulatory models of the CSOs’ economic activities. There are two main issues pertinent to the CSOs’ economic activities that are subject to regulation: 1) the permissibility of the engagement in economic activities and 2) the tax treatment of the income generated from such activities. The question is therefore whether CSOs are allowed to perform direct economic activities generating profit and if yes, what is the taxation of the earned income.

3.1. European Regulatory Models of the Permissibility of CSOs’ Engagement in Economic Activities

In almost all European countries CSOs are generally permitted to directly engage in economic activities. However, due to the core characteristics of non-profit organizations, economic activities may be limited by certain conditions. Based on the similarities in the regulatory approaches we identified the following 3 models of the permissibility of the CSOs’ engagement in economic activities:

<table>
<thead>
<tr>
<th>1st Model</th>
<th>2nd Model</th>
<th>3rd Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct economic activities are permitted without limitations, except for those arising from the core principles characterizing non-profit organizations</td>
<td>Direct economic activities are generally permitted with some limitations and requirements related to the:</td>
<td>Direct economic activities of CSOs are not allowed, however, it is possible to engage indirectly through a business corporation.</td>
</tr>
<tr>
<td>A. Purpose of the engagement</td>
<td>A. Purpose of the engagement</td>
<td></td>
</tr>
<tr>
<td>B. Legal form of the organization</td>
<td>B. Legal form of the organization</td>
<td></td>
</tr>
<tr>
<td>C. Registration of the economic activities</td>
<td>C. Registration of the economic activities</td>
<td></td>
</tr>
<tr>
<td>D. Utilization of the revenue from economic activities</td>
<td>D. Utilization of the revenue from economic activities</td>
<td></td>
</tr>
</tbody>
</table>
1st model

In some countries, most commonly in the Western Europe, CSOs are permitted to engage in any kind of economic activities without any limitations, except from those arising from the organization’s non-profit nature. This means, for example, that an association engaged in the environmental protection may sell T-shirts and other small goods as long as the association does not distribute the profit earned and the sale activities are not the association’s primary purpose.

Country applying this model is for example France where CSOs may engage directly in any economic activity, related or unrelated to its statutory activities. The relatedness of the CSO’s economic activities to its primary purposes becomes relevant only if there is a concern that they are creating unfair competition with the commercial sector. In addition to this, in Germany the relatedness is determinative of the tax treatment of the income earned from such activities.

2nd model

Under this regulatory model CSOs are permitted to engage in direct economic activities under certain conditions. The conditions may be related to some qualified purpose of the economic activity or requirement to register their economic activities as any other for profit legal entity. In addition, the laws may regulate the permissibility of economic activities differently for each CSO legal form. Also, there may be limitation on the utilization of the earned income. Following are the existing limitations accompanied with some country examples:

A. Limitations related to the purpose of the activity:

- Statutory purpose

One of the most common requirements is that the economic activities pursued by a CSO shall be related to the organization’s statutory purpose. For example a foundation with the statutory purpose to financially support the medical treatment for children with cancer may not be allowed to run a bookstore. However, if an association with a statutory purpose to provide trainings for students with mental disabilities is selling some training books, it may be considered as a related economic activity and therefore generally allowed.

---

The specific wording of this requirement may differ from one country to another. For example, the **Russian** Civil Code stipulates that “Non-profit organizations have the right to engage in entrepreneurial operations only insofar as such operations are consistent with and advance the goals for which the organizations were established.” In **Romania** CSOs may directly carry out economic activities that are “closely connected to the main purpose of the organization” and in **Lithuania** those that are “necessary to achieve its purposes/closely related to its operational goals.”

- **Incidental/auxiliary/not primary purpose**

Other purpose-related requirement is that the economic activity should not be the primary purpose or main activity of the CSO but only incidental/auxiliary one. This requirement is naturally arising from the non-profit nature of CSOs, however some countries decided to include it in their laws.

The interpretation of this requirement usually remains to practice, however there are a few countries clearly defining the line between primary and incidental activity in their laws. For example, the Act CLXXV/2011 in **Hungary** stipulates that an organization is deemed to be established for primarily entrepreneurial activity if 60% or more of the organization’s revenue comes from this activity. Other countries stipulating this requirement in their laws include: **Latvia, Czech Republic** or **Albania**.

- **Purpose in founding documents**

Some countries oblige the CSOs to identify the economic activities that they wish to carry out in their founding documents. For example, if an association teaching orphans to play musical instruments wishes to sell CDs as part of their activities, the statutes of the association have to expressly state this activity.

Examples include **Slovenia** where associations are allowed to engage only in activities indicated in the governing documents that are related to the primary purposes of the association. Other countries that have this requirement are **Serbia** and **Montenegro**.

---

9 Article 50(4) of the Civil Code.
10 Article 15(3) of the Fiscal Code.
11 Each law regulating three available CSO forms in Lithuania: Law on Associations, Law on Charity and Sponsorship Foundations and Law on Public Institutes articulates this condition for permissibility of economic activities in its text.
12 Section 2(7) of the Act CLXXV/2011.
13 Article 22 of the Law on Associations.
B. Limitations related to the organization’s legal form

The possibility to engage in economic activities may be restricted only for certain legal forms. For example in Slovakia, foundations are generally not allowed to engage in economic activities, except for organizing charitable lotteries, renting the immovable property, organizing cultural, educational, social and sport events, if these activities are in compliance with the public benefit purpose of the foundation and help to more effectively use its assets.14 Contrary to this, in Slovenia foundations are allowed to engage in any kind of activities, including economic activities that are necessary for the promotion and realization of the founding purposes. On the other hand, associations may carry out only those economic activities that are enumerated in the governing documents.15 In the United Kingdom, charities are allowed to exercise a “primary purpose trading” that accompany primary activities of the charity.16 In order to carry out other economic or commercial activities, they have to establish a for-profit subsidiary. These restrictions, however, do not apply to other non-profit legal forms.

C. Registration requirement

Some countries allow CSOs to perform economic activities if they register for these activities as other for profit legal entity. For example in Poland, associations may conduct economic activities if they are registered with the court register of business entities.17 Similarly, CSOs that want to conduct non-statutory economic activities in Slovakia and Czech Republic have to obtain a trade license which is a formal requirement for conducting entrepreneurial activities.18

D. Limitations related to the utilization of the profit from economic activities

Civil society organizations are governed by the principle of non-distribution. As explained in the first chapter, this means that CSOs cannot distribute their profit to owners, members, officers, directors, agents, employees and other private parties that may be in the position to control the organization for personal gain. In addition to this, some countries limit the utilization of the profit from economic activities only to some specific purposes. Most commonly, the profit shall be used solely for the achievement of the statutory goals and performing the primary activities of the organization. This is the case for example in Bosnia and Herzegovina, Czech Republic, Kosovo and Slovenia.

14 Article 29 of the Law No. 34/2002 Coll. on foundations.
15 Article 2 of the Law on Foundations, Article 22 of the Law on Associations.
16 Article 60B of the Charities Act 2006.
17 Article 7.1. of the Law on Economic Activities.
18 These requirements are not specifically articulated in the laws and sections about CSOs, however, they could be derived from the general regulation of economic/entrepreneurial activities.
Consequently, most of the jurisdictions are combining described limitations to economic activities and apply their own requirements for permissibility of CSOs’ economic activities. Following are few examples of the specific country regulations:

**Czech Republic**

Associations are allowed to carry out auxiliary economic activities if these activities aim to support the association’s statutory activities or contribute to the better management of the association’s property. Furthermore, the profit generated from such activities may be used solely for the association’s activities, including the administrative costs. The Civil Code sets similar conditions for foundations and funds: they may carry out only auxiliary economic activities and the profit from such activities shall be used only for the support of foundation’s statutory purpose. Registered institutes and public benefit corporations are allowed to engage in economic activities as long as it does not negatively influence their service provision and jeopardize its quality, scope and accessibility. The profit shall be used solely to support statutory activities or cover administrative costs. Finally, the social co-operatives can freely carry out any economic activities as it is one of the main characteristics of this legal form.¹⁹

**Lithuania**

Associations and charity and sponsorship foundations are allowed to carry out economic-commercial activity which is not prohibited by law, does not contradict the organizations’ statutes and activity purposes and is necessary for the achievement of these purposes. Similar conditions apply to the public institutions, however, the wording of the law is slightly different. Public institutions are allowed to carry out economic-commercial activities that are in compliance with law and are closely related to its operational goals.²⁰

**Serbia**

Associations, foundations and endowments pursuing public interest objectives are allowed to engage in economic activities if following conditions are met cumulatively: (1) the activities are related to the organization’s statutory purpose; (2) they are included in the CSO’s statutes; (3) they are incidental or

---

carried out in frequency which is deemed necessary for the support of the organization’s statutory purposes; (4) CSOs have to register one major economic activity with the Companies Register.21

**Slovenia**

Different conditions apply to each CSO legal form in Slovenia. Associations may engage only in economic activities that are related to the primary purposes of the organization and necessary for their achievement. All these activities shall be indicated in the association’s governing documents. The revenue from economic activities shall be used to promote the association’s statutory activities. An institute may engage in economic activities if they are conducted with the intention to further the statutory objectives. A foundation may engage in economic activities that are necessary to promote or perform the founding purposes.22

**3rd model**

Only a few European countries do not allow CSOs to directly carry out economic activities. In such cases, CSOs may engage in economic activities indirectly, either through establishing a commercial entity or participating in one as a shareholder or partner. However, this creates significant administrative and financial burden especially for the small CSOs that have a few employees. Therefore, the number of countries applying this regulatory model in Europe is decreasing. In the past few years several countries including **Macedonia** or **Ukraine** passed laws allowing direct engagement of CSOs in economic activities.

**Turkey** and **Belarus** are the European countries that are still prohibiting direct engagement of CSOs in economic activities. In **Turkey**, both associations and foundations have to establish or incorporate an economic enterprise in order to carry out economic activities. These entities are consequently treated in the same way as any other business entity without having extra benefits. However, the profit earned can be used solely for the statutory purposes of the CSO.23

---

3.2. Regulatory Models of Taxation of CSO’s Income from Economic Activities

Second, particularly important issue is the tax treatment of the revenue from economic activities. The tax regulation of economic activities widely differs among the countries. Nevertheless, one can identify the following models based on the similarities of the regulatory approaches:

<table>
<thead>
<tr>
<th>1st Model</th>
<th>2nd Model</th>
<th>3rd Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from direct economic activities of CSOs is fully tax exempt.</td>
<td>Some income from direct economic activities of CSOs is tax exempt or enjoy preferential tax treatment under certain conditions:</td>
<td>All profit from direct economic activities of CSOs is taxed at full rate.</td>
</tr>
<tr>
<td></td>
<td>A. Destination of income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>B. Relatedness approach</td>
<td></td>
</tr>
<tr>
<td></td>
<td>C. Threshold approach</td>
<td></td>
</tr>
</tbody>
</table>

The tax treatment of an organization may depend on its legal form or status. This may apply also to the tax treatment of the income from economic activities, when some CSOs are exempt from the profit tax on economic activities whereas the other ones are fully taxed at a general tax rate. For example in Ireland, Poland and UK the organizations qualified as “public benefit” or “charitable” are exempt from the tax on the profit from permitted economic activities. However, the rest of the organizations are taxed at a full rate.

1st model

Some countries fully exempt certain CSOs from the income tax, including income from economic activities. This is the case for example in France where CSOs are generally exempt from all taxes, including profit tax from economic activities, provided that they comply with the non-distribution constraint and the CSO can be clearly distinguishable from a commercial enterprise in accordance with the Tax Instruction 2006. There are additional conditions set for the CSOs with annual revenue...
exceeding €60,000 to be tax exempt, including “four P rule” for the goods and services provided by CSOs.24

2nd model

In this case the income from economic activities is tax exempt under certain conditions. Countries usually introduce the following approaches to determine whether the income is tax exempt or not:

A. Destination of income

Countries applying this approach are looking at the destination of the income generated from economic activities or in other words for what purposes the profit is used. While some countries fully exempt all income used for the qualified purposes, others set a threshold for tax exemption and the rest of the income is taxed at the full or reduced tax rate.

The destination of income with threshold approach is used for example in Montenegro, where all the profit below €4,000 is tax exempted, provided that it is allocated for financing statutory goals for which the CSO was established.25 The destination of income approach is used also in Poland and Kosovo.

B. Relatedness approach

As described earlier, in some countries the relatedness approach is a precondition to allow economic activities. In this case it is a criteria for decision-making about the tax treatment of the income from such activities. As explained earlier, the relatedness approach focuses on whether the economic activities carried out by a CSO are sufficiently related to the primary/statutory purpose of the organization.

The relatedness approach is used for example in Germany, where the profit from economic activities that are necessary to pursue organization’s statutory purposes and not creating an unfair competition with for-profit organizations is exempt from profit tax. Income from commercial activities that are not necessary to pursue statutory purposes of the CSO is taxed at a general rate if the annual gross income exceeds €35,000.26

---

C. Threshold approach

This approach is usually combined with the previous ones, setting a ceiling for the tax free treatment of the income from economic activities. The laws may introduce various ceilings, from RSD 400,000 (approx. € 3,270) in Serbia; € 4,000 in Montenegro up to € 35,000 in Germany. In some cases the threshold is determined in percentage. As an example in Hungary, the income from business activities shall not exceed 15% of the total income of the public benefit organizations to be exempt from paying tax.27 In case of foundations or associations without public benefit status such threshold is 10% and the income from business activity shall not exceed 10 million HUF (approx. € 32,500).28

3rd model

Some countries tax all profit from CSOs’ economic activities at a general tax rate. This means that CSOs have to pay the profit tax from the income generated from economic activities under the same conditions as any other for-profit legal entity. For example in Slovenia the CSO’s profit shall be taxed if the organization engages in for-profit activity and through this activity the CSO competes with other for-profit legal entities on the market.29 Similarly, in Turkey where CSOs are allowed to engage in economic activities only indirectly through for-profit legal entities, all the profit earned via such entity is fully taxed despite the non-distribution constraint burdening such income.30

---

27 Article 9 (7) of the Corporate Income Tax Law
28 Article 20 (1) a) of the Corporate Income Tax Law
29 Article 9 of the Corporate Income Tax Law.
4. Other Related Issues

4.1. Social Enterprises

The term social enterprise entails an organization, either for-profit or non-profit, actively performing socially beneficial economic activities. In a broader sense social enterprise may be defined as “a business created to further a social purpose in a financially sustainable way.” According to other definition applied by UK Government, social enterprise is “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.”

Social enterprises are therefore involved either in the reintegration of the marginalized groups into the labor market or in the provision of services of general interest. As an example, social enterprise reintegrating marginalized groups into the labor market may be a restaurant employing people with mental or physical disabilities. Example of social enterprise providing services of general interest could be an organization organizing reeducation trainings for unemployed people or young adults.

Traditionally, social enterprises may operate in both for-profit and non-profit legal forms as long as they comply with the following governance, economic and social criteria:

1. The governance criteria:
   - **Autonomy**: Social enterprises are voluntarily established, independent, private legal entities operating without any direct or indirect influence of public authorities;
   - **Decision making power not based on capital share**: Social enterprises are usually governed in accordance with the democratic principle of one member having one vote, rather than distributing votes based on the size of the founder’s/member’s stake in the share of capital or assets of the organization;
   - **Ownership**: Social enterprises operating as membership organizations are traditionally collectively owned through co-operative or non-profit structures, however, private businesses may be also considered as social enterprises as long as they are established to further social goals rather than to earn profit.

---

31 Definition adopted by NESsT, organization operating as a catalyst for social enterprises in emerging markets. For more information please visit NESsT’s official website: [http://www.nesst.org/](http://www.nesst.org/)

2. The economic criteria:

- An economic activity producing goods and/or selling services - Social enterprises are typically engaged in active sale of goods or services pursued with some frequency rather than advocacy issues or distribution of funds;
- A trend towards paid work - As a norm, an organization shall have at least one employee in order to be considered as social enterprise.

3. The social criteria:

- An explicit social purpose – The primary purpose of their activities is to benefit the community or a specific group of people rather than to generate profit;
- Limited distribution of profits - Social enterprises may be established both in a non-profit and for-profit form, bounded by the non-distribution constraint. However, for-profit forms are also limited in terms of distribution of surpluses and the majority of financial revenues shall be reinvested to further their statutory goals.33

Social entrepreneurship is expanding in Europe. According to the information published by NESsT in 2014, social enterprises represent 10% of the companies and generate 6% of the total employment in the European region.34 In order to support the creation of such organizations, various European countries adopted laws and policies introducing benefits for social entrepreneurship. The legal environment for social enterprises entails following positive impacts:

- Enhances the visibility of the social economy;
- Helps to identify social enterprises;
- Facilitates the development of social enterprises;
- Introduces legal basis for measures and policies supporting social enterprises;
- Helps to determine the economic power of social enterprises;
- Provides general obligations for the government to support social economy.

Legal frameworks for social enterprises may be diverse. Some countries apply so-called “open regulatory model”, which focuses on the outcome of the organization’s activities, rather than the legal form involved (e.g. Slovakia, Slovenia or Spain). Other countries introduced a distinct legal form for social enterprises (e.g. Czech Republic, Italy or UK).35 However, even in these countries social enterprises may operate in other legal forms including, among others, associations and foundations in

---

35 Czech Republic: social cooperative; Italy: social cooperative; UK: community interest company.
Italy and charities in the UK. Also, social enterprises may be regulated in a distinct law or it may be introduced through the amendment of existing laws.

The supportive laws for social enterprises acknowledge the specific nature of such organizations and provide them with additional benefits vis-à-vis other legal entities. For example in Spain and Slovenia, social enterprises furthering work integration of the disadvantaged groups may receive direct or/and indirect subsidies from the state. Social enterprises are also traditionally eligible for tax benefits, in particular profit tax exemptions/benefits and VAT benefits on the goods and services they provide.

4.2. Legal regulation of passive investments

Passive investments are excluded from the definition of economic activities employed by this paper. However, since they are considered as a source of CSOs’ income, this section will highlight the most important issues related to their legal regulation.

CSOs are traditionally subject to general legal regulations and are permitted to invest their assets as any other for-profit legal entity. However, there are a few countries limiting the possibility of CSOs to invest, in particular with regard to their endowments. In the narrow sense endowment is a specially designated amount of assets that are to be maintained permanently and used to support the CSO’s statutory purposes.

Limitations can be found in Slovakia where Article 30 (1) of the Law on Foundations stipulates that “the endowment may not be donated, invested as a deposit into a commercial company, pledged, or otherwise used to secure any obligations of the foundation or of third parties”.

One can identify the following three regulatory models in Europe regarding the tax treatment of the income from passive investments:

1. All income is tax exempted- in Poland or Czech Republic CSOs are exempted from paying tax on passive investments;
2. Some income is exempted- for example in Montenegro up to € 4000 is exempted, in Armenia certain types of passive investments are exempted;
3. All income is taxed- in Slovakia or Slovenia income from passive investments is fully taxed.

---

5. Conclusions and Lessons Learned

Based on the presented European practices in regulation of economic activities following conclusions may be extracted:

- **Economic activities as key source of income for CSOs** - Economic activities proved to be an important source of income for CSOs all around Europe. They play critical role in the CSOs’ efforts to diversify funding. According to international standards and European best practices, CSOs shall be allowed to directly engage in economic activities.

- **Conceptual distinction between economic and business/commercial/entrepreneurial activities in some European countries** - Some European countries tend to make a conceptual distinction between economic activities and business activities, considering the latter as having a direct counterpart in the for-profit sector and being unrelated to the statutory purposes of the CSO. This distinction may have an influence on the permissibility of the specific activity and tax treatment of the income.

- **Direct economic activities of CSOs are permitted in all European countries except of Belarus and Turkey** - Governments around Europe acknowledged that the income from economic activities has potential to resolve the challenge of CSOs’ financial sustainability. The Laws in almost all European countries allow CSOs to directly engage in economic activities, thus not requiring them to establish for-profit legal entity for this purpose. The exceptions from this general practice could be found in Belarus and Turkey.

- **Compliance with the non-profit character of CSOs** - Allowing CSOs to engage in economic activities does not provide them an exception from the obligation to comply with the principles of non-profit operation. These include non-distribution constraint of the profit earned among owners, members, officers, directors, agents, employees and other private parties that may be in the position to control the organization for personal gain. Also, the primary purpose of the organization shall be non-profit.

- **Qualified purpose of the economic activity as core permissibility requirement** - In many European countries CSOs are allowed to engage in economic activities if they are related to some qualified purpose- most commonly statutory, or if the purpose is only incidental/auxiliary. This requirement is core to the permissibility of CSO’s engagement in economic activities. Other requirements include registration with state authorities, limitations in terms of utilization of such income and qualified legal form.
• **Preferential taxation as best practice** - The majority of European countries provide preferable tax treatment for CSOs after their income from economic activities. Some countries grant tax exemption/tax benefits without any additional requirements, others introduced conditions for determining whether the income is eligible for preferential tax treatment or not. Only a few European countries treat CSOs in the same way as for-profit organizations and tax all their income from economic activities.

• **The expansion of social entrepreneurship in Europe** - Social enterprises are being widespread in Europe representing 10% of the companies and generating 6% of the total employment. They play critical role in the efforts to reintegrate socially marginalized people into the labor market and provide services of general interest. Governments around Europe acknowledged their specific nature and provide social enterprises with benefits in order to support their operation and enhance the creation of new ones.

• **Various approaches towards regulation of social entrepreneurship in Europe** - Countries tend to use different regulatory approaches when establishing the legal framework for social enterprises. Some of them introduced a distinct legal form of “social enterprise”, others are primarily concerned with the outcome of the organization’s activities rather than the legal form. Furthermore, the legal regulation may be introduced by a comprehensive law on social entrepreneurship, but also introduced through amendments in other already existing laws.