



Legal vehicles for social enterprises: Italian short-sightedness on profit distribution

By Roberto Randazzo

Globally, social enterprise law is moving towards entrepreneurial solutions with social impact through the creation of low profit businesses.

Italy was left on the starting blocks due to its traditional ban on profit distribution, but the law is changing and traditions are evolving.

Introduction

In Italy, as in many other countries, social entrepreneurship can be placed at a virtual crossroads between creative capitalism and social innovation.¹

Being at such an intersection, social entrepreneurship often suffers from a lack of adequate legal vehicles, which are mainly designed for the traditional business or not for profit sectors. Over the last few decades the Italian legal framework has been reshaped multiple times with the aim of facilitating social entrepreneurship; however, none of these changes succeeded in removing the absolute ban on distributing profits, which, if accomplished, would significantly boost the development of social enterprise in Italy.

Indeed, the Italian legal framework has failed to adapt to an evolving third sector and thus is hindering the development of an emerging sector representing, today, almost 6% of the Italian GDP². This legal gap needs to be successfully filled.

¹ Management theorists like Peter Drucker and social entrepreneurs such as founder of the Open University, Michael Young, were already discussing this issue in the 1960s.

² Data provided by the OECD (available on <https://stats.oecd.org/>).

Legal context

Different 'Third Sector' movements

Italy recently experienced a deep cultural, social and economic crisis. On the one hand, new social-based legal and economic frameworks, overcoming the traditional capitalistic economic model, became more and more popular as innovative instruments, thereby solving pressing issues such as unemployment, slow economic growth, social inequality, state inefficiency, welfare and lack of resources. On the other hand, two kinds of "third sector" movements emerged at the same time thereby hindering each other: one mostly driven by voluntary principles and undoubtedly not for profit-oriented and the other with a clear entrepreneurial attitude aiming at social goals through the form of a low-profit business. It is necessary to clearly distinguish, from both an ideological and a legal perspective, these two different sectors.

Legal vehicles available to social enterprises in Italy

In Italy, organizations recognized as "social enterprises" are governed by a complex, fragmented legal framework. Laws governing social enterprises are either outdated (e.g. the not-for-profit legal entity section of the Civil Code, approved in 1942, has rarely been modified) or inadequately reconcile for-profit and non-profit legal principles (e.g. Law No. 381/1991, the Law on Social Cooperatives, and the Legislative Decree No. 155/2006, on the Law on Social Enterprises). In addition, the governing legal principles related to social enterprise overlap to some extent creating confusion amongst social enterprises (e.g. the framework regulation for NGOs, the Law on Public Benefit Organizations, and the Law on Social Enterprises). Nevertheless, it is widely recognized that associations, foundations, and social cooperatives are still the most prominent and commonly used legal forms for social enterprises in Italy.

Limits on profit distribution

Despite the fragmented state of social enterprise law in Italy, all legal entities within the so-called Italian "Third Sector" are still characterized by a common general obligation not to distribute profit, directly or indirectly, but rather to reinvest such profit to further their main statutory, not-for-profit goal, or to increase assets. Such limitation does not reflect the entrepreneurial spirit of the majority of legal entities currently used by social enterprises in Italy. In addition, this requirement does not correspond with prevailing European and global trends. Indeed, low profit social enterprises have been recognized and regulated in the UK and in the USA for quite some time now³. In order to align Italian social enterprises with these European and global trends, a substantial reform of the Third Sector is needed in order to accept social enterprises into the sector and to remove the non-distribution constraint. Such reform will support Italian social enterprises in their activity while preserving their social impact.

The question remains: how strong is the "non distribution constraint" in Italy and where should the upcoming reform of the Italian Third Sector be heading?

A hybrid solution

The absolute ban on profit distribution is only one of the elements characterizing legal entities of the Italian Third Sector and it's common knowledge that such requirement is not as strict or fully-armed as it seems. Within the third sector, mutual cooperatives can distribute profits within certain limits set by the Civil Code and still benefit from tax advantages. Indeed, according to article 2514 of the Italian Civil Code, mutual cooperatives are required to cap profit distribution at an amount less than the maximum interest of postal bonds accruing interest, increased by two and one half percentage points on the paid-up capital. During the last three years Postal bonds accruing interest varied from 3% to 5%. This means that profit distribution from prevailing mutual cooperatives cap profit at 5% to 7% of paid-up capital. The same cap on profit distribution could be generally applied to the whole social enterprise sector. According to current Italian law, this cap is not yet applied to social enterprises. Paradoxically, social enterprises, as defined by the Legislative Decree No. 155/2006 (private legal entities, including limited companies, satisfying the criteria of the legal entity status and engaging in a specific list of activities having

³ Some examples of low profit social enterprises include: Community Interest Companies (CIC) in the UK, Low-Profit Limited Liability Companies (L3C) and Benefit Corporations in the US.

“social utility”), are still banned from distributing profits. Ironically, an innovative start-up entity with a social mission, recently introduced by Law No. 221/2012, is banned from profit distribution during the first 60 months from ~~their~~its constitution. At the end of this period, the entity may distribute profits without any cap or limitation.

Due to these barriers, the current debate on the reform of the Italian Third Sector including social enterprise law is moving towards a hybrid solution focused on introducing adequate remuneration of shared capital and profit distribution, limited by an appropriate allocation of resources to the social goals of the entity and capped, as mentioned above, by the provisions applying to mutual cooperatives. Social enterprise law is still relatively undeveloped in Italy especially due to the lack of legal harmonization between the different sectors; however, despite this initial impasse, Italy is now beginning to follow major global trends and early signs of future legal development seem to be quite promising.

Evolution

After the economic crisis, Italy is still going through a very difficult period characterized by a strong desire to renovate and change Italian law. Accordingly, the blending of for profit and non-profit hybrid legal structures is spreading in the Italian legal and business communities as an innovative tool which could lead to the enhancement of innovation, motivation, reputation, and finally trust between the different for profit and non-profit sectors. This new movement is expected to increase economic stability and generate a better distribution of social equity.

The advantages of a hybrid solution benefit all actors within each sector. On the one hand, commercial companies better understand and anticipate customer and citizen needs. On the other hand, the non-profit sector benefits from the resources, experience, and networking capabilities of the for-profit sector.

The draft law on reforming the Third Sector, approved in July 2014 by the Council of Italian Ministers and currently being debated, reflects this whisper of change.

The reform intends to:

- a. Allow remuneration for capital and profit sharing, opening the possibility of having low profit enterprises in Italy as well as international capital-sharing schemes;
- b. Redefine social enterprise as a private enterprise with objectives of general interest, the primary purpose of which is to achieve a measurable positive social impact;
- c. Guarantee the qualification of social enterprises for those organizations complying with the requirements. This will consequently expand the list of sectors carrying out socially useful activities, and identify compatibility limitations for commercial activities that lack social objectives.
- d. Rationalize the categories of disadvantaged workers in order to take into account new forms of social exclusion (e.g. refugees).
- e. Coordinate the discipline of social enterprises with the system regulating business activities carried out by socially useful non-profit organizations.

During the twelve months after the entry into force of the law, the Italian Government will adopt the legislative decrees to reform the sector.

The contents of the proposed reform of the Third Sector is full of promise and provides a glimpse of how the Italian context is evolving. There is still a gap between the evolution of social enterprise at a global level and the situation in Italy. However, the first steps taken by the Italian Government show the potential for the legal development of social enterprise in a very positive direction.

The fact that capped profit distribution⁴ is already required for mutual cooperatives proves that hybrid solutions are possible under current Italian law and are certainly not a brand new idea in Italy.

⁴ Provided by the Italian Civil Code since 1949.

The extension of a cap of profit distribution to all social enterprises could actually be the easiest, and yet, most disruptive reform to the Italian Third Sector. Indeed, sometimes the simplest solution is the last to be considered.

Resources

For more information on this topic, consult the following links/publications:

1. <http://evpa.eu.com/wp-content/uploads/2013/02/ECNL-on-socent-in-Europe.pdf>
2. http://ec.europa.eu/regional_policy/sources/docgener/presenta/social_innovation/social_innovation_2013.pdf
3. <http://www.socialimpactinvestment.org/reports/Rapporto%20Italiano%20Ultima%20versione.pdf>
4. <http://www.vita.it/it/article/2015/05/14/impresa-sociale-quegli-abbagli-su-distribuzione-degli-utili-e-agevolaz/134177/>