

Legal Structures for Social Enterprise in BC



THIS SESSION IS PRESENTED BY:
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This document:

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- This document was used in presentations that were delivered live in Vancouver and Victoria, in June 2013, to an audience of around 150 people over two afternoons.
- Slides have been removed / modified, relating to session group work, and time markers.

What the document covers:

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- Social enterprise working definition
- Social enterprise motivators
- Considerations for choosing a legal structure
- Legal structures commonly used by social enterprise
- The new Community Contribution Company (C3)



BC CENTRE FOR SOCIAL ENTERPRISE



- Stacey Corriveau, Founder of the BC Centre for Social Enterprise (BCCSE), Abbotsford
- BCCSE is a charity and a non-profit sharing a common brand
- Launched in 2005 as a project of Community Futures South Fraser
- Offers education and counselling to support social enterprise launch and operations



What is 'social enterprise?'

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What is social enterprise?

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- Not a legal expression in Canada
- Not addressed in the federal *Income Tax Act*
- ...so for now, we create our own definitions, which emerge from the actual experiences of social enterprise practitioners.

One working definition...

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The definition proposed by Causeway is a solid one:

‘Social enterprise is defined as any organization or business that uses market-oriented production and sale of goods and/or services to pursue a public benefit mission.’

Broad in terms of ownership.

Must be selling something 😊



Why do it?

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Quotable quote:

‘Charities and non-profits rely on three core sources of revenue: government funding, philanthropy, and earned income. Of these, only earned income offers any prospect for long-term growth.’

Why and how?

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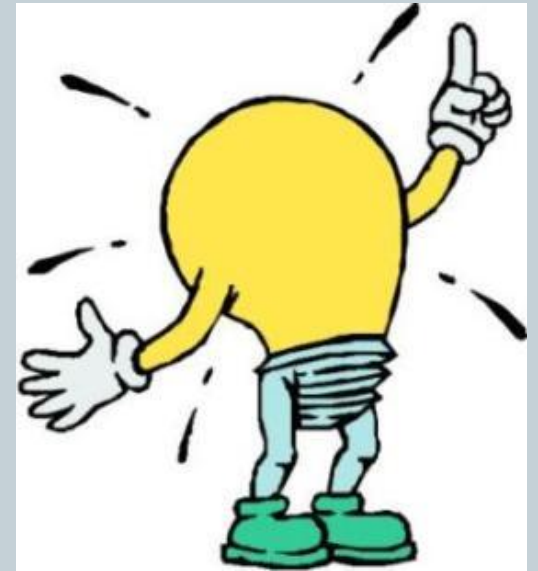
2010 survey of community-based SE's, BC and AB n=140

Primary purposes:

- Mission-based – 43.4%
- Employment development – 32.1%
- Income generation for parent org. – 24.5%

Legal structure:

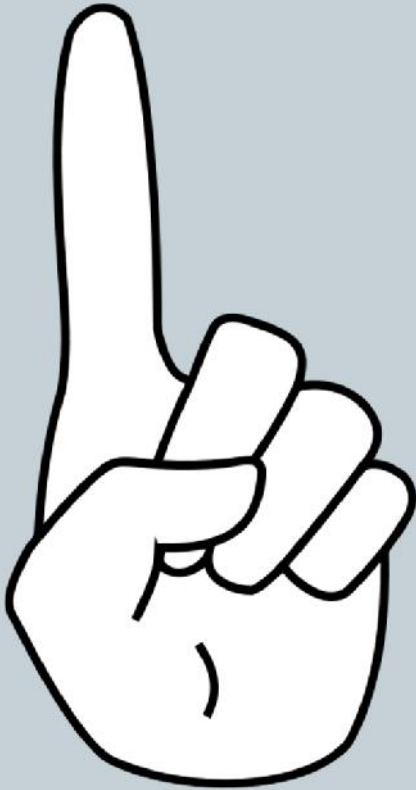
- Registered charity – 51%
- Non-profit – 28%
- Co-operative – 13%
- For-profit – 6%



Strength, Size, Scope: A Survey of Social Enterprises in Alberta and British Columbia by Peter Hall profiles data from 140 of 295 social enterprises in both provinces gathered in the spring and summer of 2010.

SE motive #1

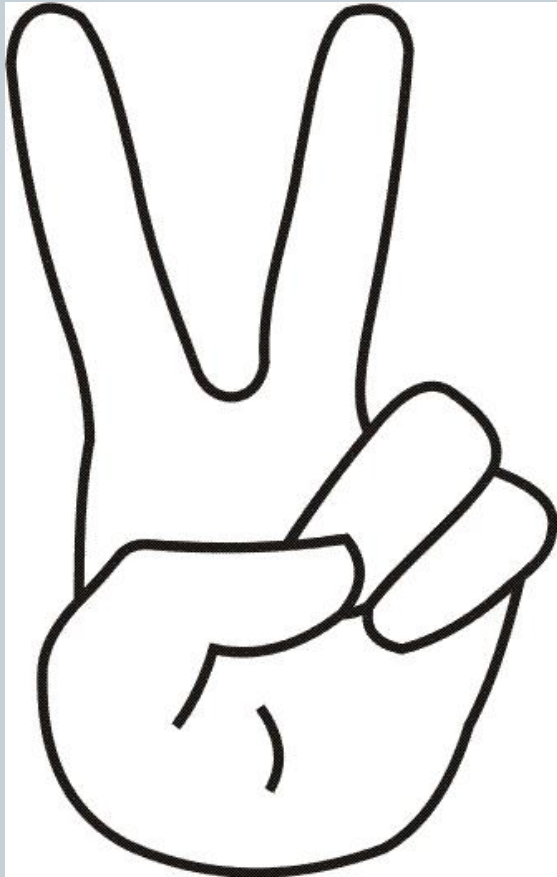
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- To meet a need which is unmet within the traditional marketplace...
- Goal is market improvement...
- Examples could include specialized transportation services, care services, or consulting services in a niche area.

SE motive #2

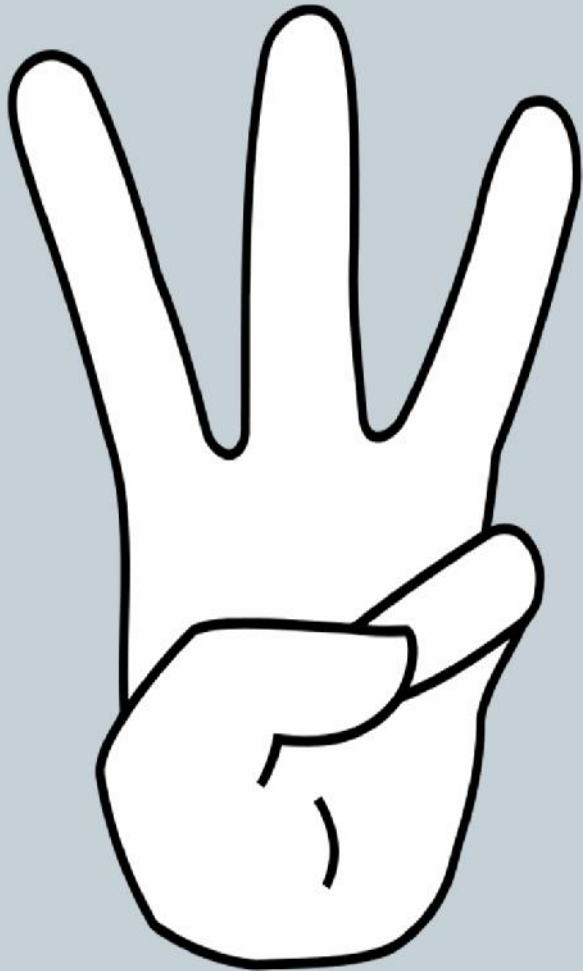
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- To generate profits in order to enjoy greater community impacts, or to lessen reliance on funding...
- Goal is organizational (financial) sustainability...
- Examples could include operating a food franchise or large retail operation, or offering a service such as property or event management.

SE motive #3

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- To provide training or employment opportunities for clients...
- Goal is building citizenship / contribution, skills, and finances of clients...
- Examples would include a range of goods and service provision, with a stress on skills development.

SE motives...

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- SE motives can be blended.
- Potential pitfall: coupling a high profit generation motive with creating employment or training opportunities for people in need.
- Generally, employment / training SE's incur higher costs of, on average, 33%! Φ

Social enterprise motivators



‘Preliminary considerations’

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- Source: MaRS White Paper Series, *Social enterprise in Canada: Structural options*, December 2011 (link on workshop webpage)
- Susan Manwaring and Andrew Valentine (Miller Thomson LLP) have adapted the American work of Jim Fruchterman
- Primary message: don't let the tail wag the dog when choosing a legal structure... be clear on what your goals and priorities are, before choosing.

‘Preliminary considerations’

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1. Motivation
2. Control / governance
3. Market
4. Capital



‘Preliminary considerations’

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1. Motivation

‘If financial return is the primary goal of the venture ... then the optimal structure may be one that affords greater flexibility... to pursue economic opportunities. If the social goal is paramount, then... choose a structure that ensures that the social purpose remains the dominant factor in operational decision-making.’

‘Preliminary considerations’

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2. Control / governance

‘The question of how and by whom control over the venture will be held is central to the structural question.’

‘Entities that benefit from favourable tax treatment are generally subject to greater limitations on the extent to which a single person or related group may control the organization...’

‘Preliminary considerations’

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3. Market

‘Understanding the customer is perhaps the most important consideration.’

‘The scale of the operations, as well as the relative ease with which the venture is anticipated to be profitable, will influence whether to structure the venture as a for-profit or non-profit.’

‘Preliminary considerations’

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4. Capital

‘If the venture can be initiated for relatively low costs, then there will be greater flexibility in terms of [structure choice].’

‘Generally speaking, greater needs for capital and financing flexibility... will suggest a for-profit structure.’ **Φ**

Commonly used legal structures for SE

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Traditional structures available...

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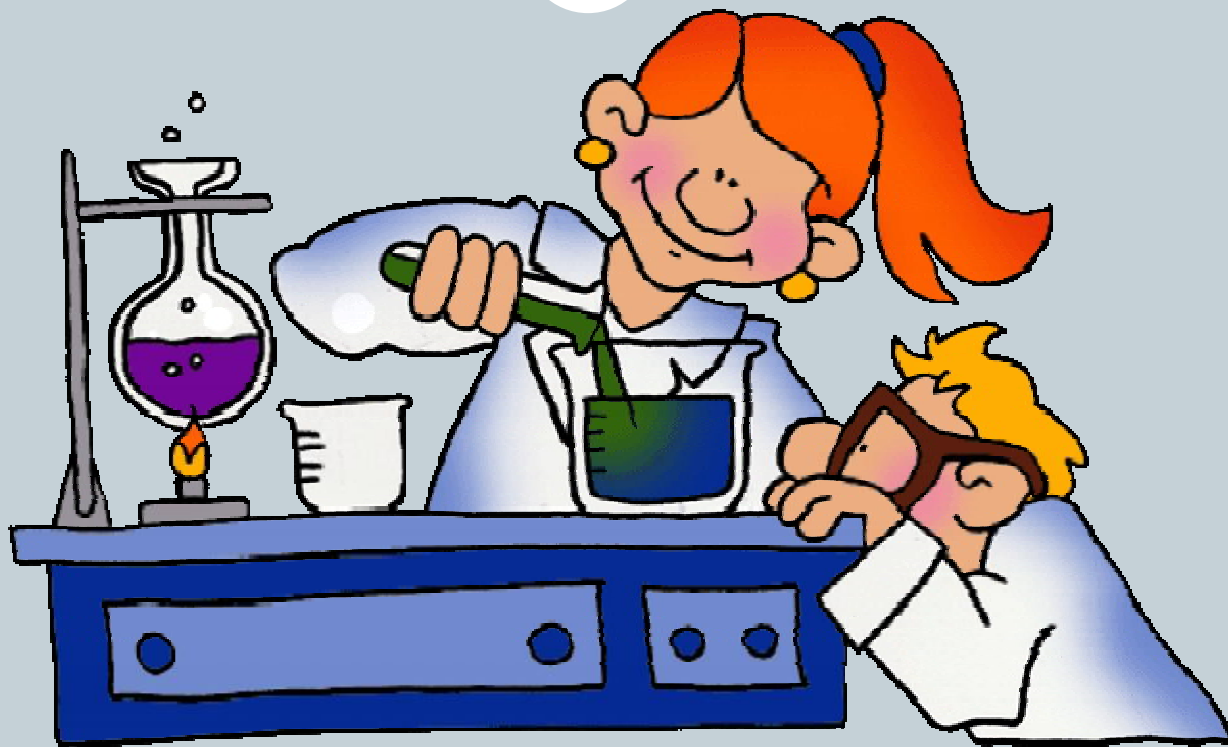
Legal structures commonly used as containers for social enterprise activity in Canada are:

- Charities
- Non-profit societies
- Co-operatives
- Corporations

(Joint ventures are not intended for ongoing business activities).

Coming soon– the C3

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Bill 23, Finance Statutes Amendment Act, 2012

Province of British Columbia

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- Introduced the **Community Contribution Company (C3)**
- Stemmed from consultations among non-profits engaged in or entering the SE realm, 2010-2011
- Introduced to the BC Legislature March 2012 and passed into law in May 2012
- Resembles the UK's Community Interest Company (CIC)
- Will come into force in BC on July 29, 2013.
- Ministry has no budget to promote or educate.



Charities – features

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- Inexpensive to set up
- First form non-profit, then apply for charitable status
- Detailed CRA application process, 6-month average wait with no guarantee
- Purposes must fall under 1 of 4 charitable ‘heads’
- Social purpose is legally entrenched
- Heavy regulation and reporting requirements

Charities – features (con't)

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- Tax exempt
- Asset locked
- Can apply for grants from charitable organizations, foundations, and more
- Can issue official tax receipts for donations
- Favourably viewed by the public
- Subject to 3.5% disbursement quota
- Cannot sell investment shares

Charities – overview

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All charities are non-profit societies...

...Not all non-profit societies are charities!

4 charitable heads:

1. the relief of poverty
2. the advancement of education
3. the advancement of religion
4. other purposes that benefit the community in a way the courts have said are charitable

Charities – allowable activities

30

3 important activities that are not ‘business’...

- Soliciting donations
- Selling donated goods (narrowly defined – not thrift stores; CRA clarification expected soon)
- Fees charged for charitable programs and services.

Factors:

- ✦ Fees set to defray costs of the program, not make profit;
- ✦ Comparable services are not available in the market;
- ✦ Fees set according to charitable - not market - goals.

Charities – Related Business

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- Generally, an enterprise must meet 90% volunteer rule, **or** be linked and subordinate to the charity's purposes ('related business') in order to operate as a project within the charity.
- Can benefit from charitable donations and grants.
- Simpler to administer as 'project' of the charity (versus separate structure).
- Liability issues?

Charities – Unrelated Business

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- If the social enterprise does not meet one of these tests, then it must be hived off into a taxable corporation ('unrelated business'). May use C3 here.
- The corporation can donate up to 75% of its profits to the charity.
- The corporation then pays income tax on the remaining 25%.
- Strict governance and financial separation between the charity and the corporation is required.
- Charity can fund the business only under very limited circumstances (i.e. prudent investment).

Charities – linkage tests

‘Linkage’ to the organization’s charitable purpose means that the business must meet one of the following tests. It must:

- Be a usual and necessary concomitant of charitable programs (e.g. a hospital parking lot, a university bookstore); or
- Be an offshoot of a charitable program (e.g. a church that records and sells choir recordings); or

Charities – linkage tests (con't)

34

- Represent a use of excess capacity (e.g. charging for parking lot use during hours of closure, or renting out event tents when not being used by the charity);
or
- Involve the sale of items that promote the charity and its objects (e.g. calendars, T-shirts, etc.).

Common thinking error: charities assuming that their social enterprise is a related business when it is not – thereby jeopardizing charitable status.

Charities – subordination

35

‘Subordination’ to the organization’s charitable purpose means that the business must meet all of the following tests.

- a) ‘Relative to the charity’s operations as a whole, the business activity receives a minor* portion of the charity’s attention and resources.’

*('minor' is not defined)

Charities – subordination (con't)

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- b) 'The business is integrated into the charity's operations, rather than acting as a self-contained unit.'
- c) 'The organization's charitable goals continue to dominate its decision-making.'
- d) 'The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter its operations.'

Charities – employment-related training

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Generally charitable:

- Provide instruction to complement the on-the-job training
- Limited-time employment
- Offer job placement support
- Proportion of target group to total workers should be 70% or higher
- ‘The focus of the activity must be to further a charitable purpose, not to generate revenue.’

Charities – social businesses

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Generally charitable:

- ‘the workforce is composed entirely of individuals with disabilities, with the exception of employees who provide necessary training and supervision;
- ‘the work is specifically chosen and structured to take into account the special needs of [the disabled workers].’
- ‘a social business must focus on helping eligible beneficiaries and not on making a profit.’

Charities – related reading

39

CRA, What is a Related Business? CPS-019 2003

CRA, Community Economic Development Activities and Charitable Registration, CG-014 2012





Non-profit organizations - features

41

- Roughly 80,000 in Canada (same amount as charities)
- Easy and inexpensive to set up
- Light touch regulation and reporting
- Range of allowable community activities; social purpose is legally entrenched
- More flexible (than charities) in grant making destinations

Non-profit organizations – features (con't)

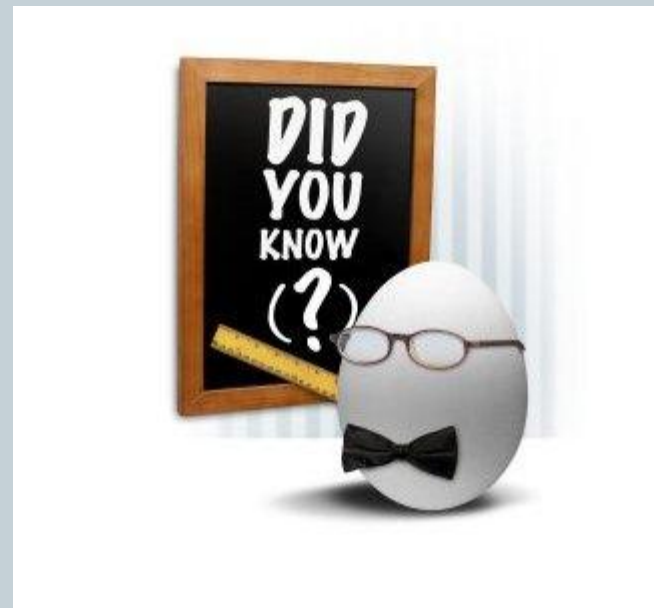
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- Tax exempt
- Favourably viewed by the public (most folks conflate charities and non-profits)
- Cannot apply for grants from charitable organizations, foundations, etc.
- Cannot issue official tax receipts for donations
- Cannot sell investment shares

Non-profit organizations – did you know?

43

- If the activities of the non-profit ‘fit’ within one of the four ‘heads’ of charity, the non-profit is expected to apply for charitable status.
- That is... cannot ‘choose’ to ‘stay’ as a non-profit if in fact charitable.



Non-profit organizations

44

Section 149.1 of the federal *Income Tax Act* under ‘miscellaneous exemptions’...

Non-profit organizations

(1) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof...’

Non-profit organizations

45

- It was generally believed that the non-profit structure was a 'safer' haven for social enterprise operation, since there seemed to be tighter limits on charities operating social enterprises.
- Seven CRA rulings and two pieces of case law (court decisions) suggest otherwise.
- Key ruling: November 2009.
- CRA estimates that 75% of non-profits are currently offside.

Non-profit organizations

46

Questions asked were...

- Can a 149(1)(l) organization [i.e. a non-profit] earn a profit?
- If the profit is intentional, but used to fund the activities of the organization, will the organization qualify for the 149(1)(l) exemption from tax?
- (Short) answers: 'only by mistake' and 'no'.

Non-profit organizations

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- Only exception – accumulating surpluses for future acquisition of capital assets for community benefit
- Contracts with mark-ups prohibited
- Definition of ‘profit’?
- CRA has already completed two rounds of audits, with a target of over 1,400 NPO’s.
- Consequence if audited – loss of tax exemption for entire org., and retroactive taxation on net profits to date

Common thinking error: NPO’s assuming that the ‘destination of profits test’ holds in Canada.

Our own 'intervention'

48

- Our NPO voluntarily relinquished its income tax exemption in 2011.
- We pay corporate income tax on net profits.
- Clarity on areas of intentional profit generation; continue to benefit from public trust in NPO structure; no fear of 'unfair competition' claims from for-profit consultants. Φ



Co-operatives in Canada

50

- Over 9,000 co-ops in Canada, with \$370B in assets and 18 million members
- 150,000 people employed, total
- 87,000 employed in non-financial co-ops
- 32,000 employed in the agricultural sector
- 70,000 co-op members serve on their Boards
- Non-financial co-ops gross \$30B annually

From federal Co-operatives Secretariat website 05.13 / BCCA presentation May
2013

Co-operatives

52

- Incorporated under provincial co-operative acts (sometimes under the federal act)
- In most cases, net income is taxed at corporate rates
- Differentiated by ‘one member, one vote’
- Primarily driven to achieve member benefit
- Can raise capital by issuing shares to members or outside investors
- Can institute an asset lock upon dissolution

Co-operatives

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Key principles:

1. Voluntary and open membership;
2. Democratic member control;
3. Member economic participation;
4. Autonomy and independence;
5. Education, training, and information;
6. Co-operation among co-operatives;
7. Concern for community.

Co-operatives

54

Can operate as:

1. Worker co-ops;
2. Financial services co-ops;
3. Marketing co-ops;
4. Housing co-ops;
5. Consumer co-ops;
6. Multi-stakeholder co-ops;
7. Umbrella co-ops... and more.

These are not different structures... just different modes of operating.

Co-operatives

55

- No limits on profit generation
- Can issue shares to non-members
- Dividends are capped (as in C3)
- Can pay patronage dividends, based on usage
- Surpluses must be redirected to social purposes or to improve the co-op

- Relies on a critical mass of engaged and capable members

- Democratically governed – founding members would have diminished control



Community Service Co-operatives

56

- Hybrid co-op in BC
- Introduced in 2006
- Same legal status as a non-profit, can apply for charitable status
- Cannot issue investment shares
- Asset locked upon dissolution
- Cannot distribute assets to members
- Not many have registered, remains a rare form

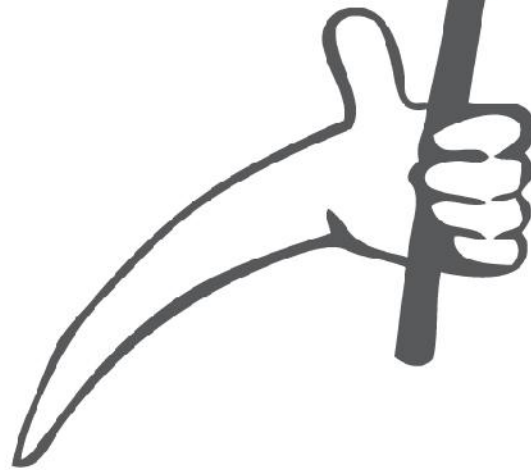
Co-ops: a clarifying thought

57

‘... some people see co-operatives as already providing an alternative form for social enterprise, but [co-ops] have certain characteristics that may limit their appeal **[from an outside investor perspective]**, such as limited investment potential, e.g. holders of investment shares generally have no right to vote on resolutions...; community service co-ops cannot have investor shares at all; control in co-ops is based on membership i.e. one member / one vote, rather than a financial stake.’

Φ

traditional
corporations



Corporations

59

- This is the structure generally recommended by CRA for charities operating unrelated business.
- Costs as little as \$350 to incorporate online, but many use a lawyer (e.g. shares can be tricky).
- Can be owned by a charity or co-operative or individual or group of individuals.
- NPO ownership could signal profit intent.

Corporations (con't)

60

- Not entitled to as many grants as community-based structures (mostly HR, R&D, green subsidies).
- Not entitled to receive charitable donations.
- Can sell investment shares and issue debt instruments.

Corporations (con't)

61

- Free to use assets and revenues as it sees fit.
- No limits on profits.
- Subject to corporate tax on profits.
- Can donate up to 75% of net profits to (any) charity, reducing tax payable.
- Simple to wind-down.

Corporations (con't)

62

- No entrenched / legally codified social purpose.
- The essential objective recognized by corporate law and theory is the maximization of shareholder value.
- The majority can vote to change this priority, but the decision can be reversed by future shareholders.

Corporations (con't)

63

Be aware of BC Securities Commission (BCSC) restrictions when promoting equity investment (share purchase) opportunities (applies to C3's as well).

- Without registering with the BCSC and issuing a prospectus, there are limits on those who can be approached to invest.
- *** **Do review:**
www.bcsc.ca/privateplacements.asp?id=2004

Corporations (con't)

64

Examples of acceptable investors (exemptions under BCSC) might include:

- Directors, officers, employees, or control persons
- Family members, close personal friends, close business associates
- Consultants who have done work for the company
- Accredited investors (including financial institutions and high net worth individuals)
- Single investments of \$150K or more

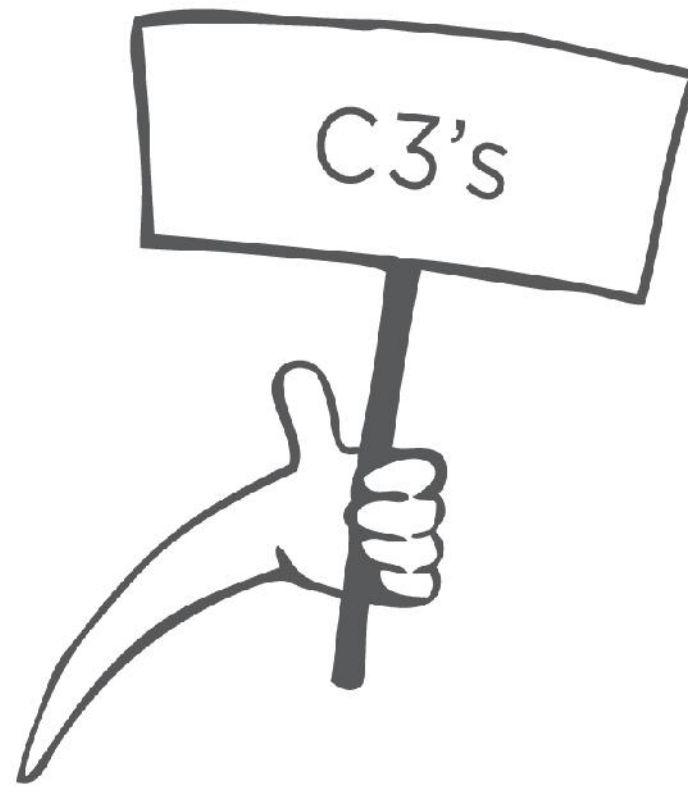
Corporations (con't)

65

Private issuer exemption is lost if more than 49 shareholders; can 'fit' under other exemptions.

'If you issue securities [i.e. shares] using these exemptions, the securities are subject to resale restrictions.'





A need for a hybrid?

67

Perhaps there are some limits on the structures that we have been adapting / adopting to serve social enterprise,

... versus options that are more purpose-built to house social enterprise?

A need for a hybrid?

68

Recent MaRS webinar on hybrid social enterprise structures cites a needed shift from...

‘shareholder capitalism’ = maximizing shareholder value

to...

‘stakeholder capitalism’ = creation of social and shareholder value simultaneously

International innovations

69

Legal structures created to support social enterprise in the US and the UK are:

- Community Interest Companies or CIC's (UK) – 2005 / 2007, n = 7,000
- Low-Profit Limited Liability Companies or L3C's (US) – 2008, n = 800
- Benefit Corporations (US) – 2010, n = 100

C3 – basic characteristics

70

- Not a new structure: embedded within the BC *Business Corporations Act*.
- Therefore, a taxable corporation with additional characteristics.
- Can be launched ‘new’, or an existing corporation can migrate to the C3 if all shareholders agree by unanimous resolution.
- Cannot revert from a C3 to a regular corporation.
- Must have commitment to community purpose codified in its corporate articles.

C3 – must have community purpose

71

‘Community purpose’ is defined as:

‘A purpose beneficial to

a) society at large, or

b) a segment of society that is broader than the group of persons who are related to the [C3],

and includes, without limitation, a purpose of providing health, social, environmental, cultural, educational or other services...’

(much broader than charitable purposes)

51.91(1)

C3 – community purpose, name

72

- A C3 can have more than one community purpose. Purposes can be changed / added over time by special resolution.
- The C3 must have either ‘Community Contribution Company’ or ‘CCC’ in its legal name. (‘C3’ not acceptable).

51.911-51.921

C3 – community purpose, con't

73

The C3's Notice of Articles must contain this statement:

‘This company is a community contribution company, and, as such, has purposes beneficial to society. The company is restricted, in accordance with Part 2.2 of the *Business Corporations Act*, in its ability to pay dividends and to distribute its assets on dissolution or otherwise.’

51.911

C3 – directors and officers

74

- Can have one or more shareholders.
- Must have at least three directors.
- Directors / officers ‘must act with a view to the community purposes of the company set out in its articles’.

51.93

C3 – transfer of assets

75

‘A [C3] must not transfer any of its money or other assets other than

- a) for fair market value,
- b) to a qualified entity [qualified donee or community services co-op],
- c) in furtherance of the company’s community purposes,
- d) for transfers... [dividends, distributions on dissolution, redemptions / purchases of shares...].’

51.931

C3 – transfer of assets

76

Aside from the methods just named, ‘no part of the money or other assets of a [C3] is to be transferred during the company’s existence or on its dissolution to a person related to the company.’

51.931(2)

C3 – dividend caps

77

- Dividends are capped at 40% of the C3's annual profit, plus unused room from previous years.
- Dividend caps do not apply to qualified entities.
- A C3 can further restrict dividends in its articles. These are the minimums.

51.94, R4-5

C3 – no interest caps

78

There are no explicitly stated interest caps.

(this is a difference from UK CIC's, which increased from 4% to 10% above the Bank of England's base lending rate in 2010 after finding that the 4% caps were not attracting investors)

C3 – dissolution (wind-down)

79

- After regular liabilities are covered, at least 60% of the remaining assets must be distributed to a qualified entity.
- The qualified entity can be named in the company's articles, or in a later resolution.

51.95

C3 – community contribution report

80

- No such report is required of regular corporations.
- Aids in providing stakeholder / community assurance that community purposes are being taken into account.
- Report must be approved by the directors.
- There is no template for this report, but certain elements must be included.

51.96

C3 – community contribution report

81

- The report is presented to shareholders at the AGM, filed in the C3's corporate record book, and posted on the C3's own website for public viewing.
- This report is NOT filed with Victoria.

51.96

C3 – community contribution report

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Required elements for this annual report include:

- A ‘fair and accurate description of the manner in which the [C3’s] activities ... benefitted society’.
- Annual financial statements.
- Details of staff positions paying \$75K or more.
- Details of dividends declared.
- Details of asset transfers in furtherance of the C3’s purposes; greater detail is required for single destinations of more than \$10,000 over the year.

51.96, R9

C3 – a clarifying thought

83

Remember that C3's are *Business Corporations Act* companies (with restricted dividends, an asset lock, and some enhanced accountability requirements).

C3's are therefore subject to the same benefits and disadvantages as other companies when compared to other structural options.

The C3 and non-profit societies

84

- A non-profit society could become a C3 (transfer assets from the society) or own a C3 (society as sole shareholder)
- If a non-profit society owns a C3, it may endanger its tax exempt status (case-by-case decision by CRA)
- As a corporation, the C3 is designed for profit generation – net profit is taxable at corporate rates (15% federal + 2.5% to 10% BC provincial)

The C3 and charities

85

- The C3 may be an attractive corporate vehicle for charities operating unrelated business.
- Community priorities are codified into the structure.
- The dividend caps would align with the goals of social financiers, leaving more resources within the C3.
- Resources would remain for community good, upon dissolution.

The C3 and hybrid ownership

86

- The C3 may be an attractive corporate vehicle for different stakeholders who wish to co-create a social enterprise.
- For example, a single C3 might be owned by a charity + a traditional corporation + an individual, etc.
- Could serve to bridge the ‘divide’ between community-based social enterprise and businesses wishing to take corporate social responsibility to ‘the next level’.

For more specific information

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Self-serve:

Check regularly: C3 page on our website

Closer to launch in July: check the BC Registry Services website

For fee:

Approach lawyers with specific experience in social enterprise structural formation

Through our own Structure Shop non-profit project: specific guidance and incorporation of all legal forms for social enterprise, supported by lawyers

Thank you...

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Stacey Corriveau can be reached at:
stacey@centreforsocialenterprise.com

Visit C3 page on our website for workshop materials.