

NEWS

The not-for-profit corporation: the ideal business model for social entrepreneurs in Switzerland?

Social enterprise is flourishing in Switzerland and more and more entrepreneurs are interested in setting up projects which combine a business model with a social or environmental impact. Would a not-for-profit corporation be the optimal legal form?

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In this article, Julie Wynne, Partner at Froriep, analyses whether the not-for-profit corporation is a suitable legal form for social entrepreneurs in Switzerland.

This article starts with an introduction on the legal framework for social enterprises in Switzerland, discuss the possibility of setting up a not-for-profit corporation for social enterprise activities and outline the main challenges faced when setting up this type of structure.

Even though social enterprise is a sector which is flourishing in Switzerland, there is no official definition of a social enterprise or a specific legal regime. The term "social enterprise" (in German: *Sozialfirmen*; in French: *entreprise sociale*) has been reserved in the past to refer to Work Integration Social Enterprises (WISE). Now, the term social enterprise is used to cover a larger scope of entities. For the purpose of this article, we will define social enterprise as an enterprise with a social mission focus and an innovative operational procedure.

Tax exemption for not-for-profit organisations and trading activities

Until recently, Swiss social entrepreneurs were mainly using foundations and associations as the standard legal form for not-for-profit organisations. This was due, in particular, to the fact that, unlike other European countries, not-for-profit organisations in Switzerland are allowed to perform trading activities.

Foundations and associations that are granted tax exemption based on their public benefit purpose may carry out a commercial activity if such activity is provided for in the by-laws and so long as the commercial activity serves the public benefit purpose of the foundation. In other words, a foundation supporting subsistence and semi-developed farming communities in Latin America can operate a for-profit shop to sell commercial products if the profit is then used towards the main public benefit purpose of the foundation.

Auxiliary business activities are permitted so long as (i) they serve to achieve the public interest purpose, (ii) are clearly subordinated to the public interest purpose and (iii) are of minor importance in light of the organisation's total revenue, i.e. the income from the trading activities should not exceed the total income from the grants and subsidies (cf. Circular of the Federal Tax Administration of 8 July 1994).

Even the acquisition and administration of a majority participation in a company carrying out business activities is allowed, provided however that this participation does not enable the not-for-profit legal entity to exercise control over the management of the company and provided that no management functions are performed by the not-for-profit legal entity.

Why a not-for-profit corporation is appealing to a social entrepreneur?

The main problem with setting up a foundation or an association (entities which do not have shareholders) is that social entrepreneurs lose control because they cannot keep ownership in the legal entity as a shareholder. This means that a social entrepreneur would need to share the power-making decision either, for foundations, with the Foundation Board or, in the case of an association, with the Executive Committee and the General Assembly of members.

Therefore the model of a not-for-profit corporation is a model which is gaining popularity. The social entrepreneur can be the shareholder and, at the same time, a director of the not-for-profit entity. This also shows to the general public that the organisation is to be seen as a business.

In order to receive charitable funding, the not-for-profit corporation could apply for tax-exempt status. The Federal Tax Authority has confirmed in its guidelines that a corporation can apply for tax-exempt

even grant tax-exempt status to not-for-profit corporations.

In theory, the option to set up a social enterprise through a corporation seems appealing. A few organisations have already used this model in Switzerland but the numbers remain small. The main hurdles for the development of this type of entities are that (i) it is difficult to find investors if they cannot receive any dividends or other financial benefits, (ii) a Board member or shareholder cannot be remunerated or employed by the organisation, and (iii) there are uncertainties about the tax treatment of the sale of the shares of the not-for-profit corporation.

The hybrid structure might be a better option

Not-for-profit corporations are an innovative option for social enterprises in Switzerland, but they are still subject to tax and legal barriers and therefore a tax regime should be developed specifically for the social enterprise sector.

For the time being, subject to the characteristics of the project, a hybrid structure combining two entities, a tax-exempt organisation for the charitable projects and a corporation for the commercial activities, is often the optimal vehicle for social enterprises in Switzerland as it combines the advantages of both a tax exemption for the not-for-profit arm and the business model of a corporation for the for-profit arm, the major disadvantage being only the complexity of the structure. There are two options for the entities to collaborate:

Parent-subsidiary: Have the not-for-profit entity as the parent organisation and the for-profit as a subsidiary owned by the not-for-profit;

Brother-sister: Operate the not-for-profit organisation and the for-profit entity as entirely separate entity which may conclude service agreements with the not-for-profit organisation.

Tips and hints for practitioners

For the time being and until tax incentives are developed to support social enterprises in Switzerland, social entrepreneurs shall often consider establishing a not-for-profit organisation at least for the launch of their social business so as to benefit from grants from grant-making foundations or state subsidies.

As soon as the business takes off, hybrid structure is in general a good legal form for a social enterprise, i.e. two entities, a tax-exempt organisation for the charitable projects and a corporation for the commercial activities. This will allow the social entrepreneur to be compensated for his/her work in the for-profit arm and be able to develop the charitable projects on a volunteer basis in the not-for-profit arm.

Resources

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

A map of social enterprises and their eco-systems in Europe – Country Report: Switzerland (2014)

<http://ec.europa.eu/social/BlobServlet?docId=13279&langId=en>

Social enterprise models in Switzerland: An overview of existing streams, practices and institutional structures <http://wp.unil.ch/ess-vd/files/2015/06/Switzerland-Gonin-Gachet-ICSEM-2015-03.pdf>

Chambre de l'économie sociale et solidaire <http://www.apres-ge.ch/>

APRÈS-GE (2014) *Etude statistique sur l'économie sociale et solidaire à Genève* http://www.ville-geneve.ch/fileadmin/public/Departement_1/Publications/cess_etude_sans_aplat_pp_DEF.pdf

Guidelines from the Federal Tax Authority regarding tax-exemption based on public interest purpose <https://www.estv.admin.ch/dam/estv/fr/dokumente/bundessteuer/kreisschreiben/2000/W95-012.pdf.download.pdf/w95-012f.pdf>

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