

# Social Enterprise, Unlimited

*To unleash social enterprise in this country, let's get it recognized under Canadian law*

BY STACEY CORRIVEAU

When I first launched the Fraser Valley Centre (now BC Centre) for Social Enterprise, I endowed it with some dazzling pieces of flawed thinking. One was that an existing business development organization was the natural place to house a Centre for Social Enterprise.

In my case, the organization in question was a Community Futures Development Corporation. It was already delivering a business curriculum and counselling, and I assumed that a Centre for Social Enterprise would simply apply the same services to a different audience. In effect, we would just fill the seats with nonprofit types and we'd be off to the races! The issues of organizational culture and capacity escaped me – at first.

Another erroneous assumption of mine, not unrelated to the first, concerned the legal structure in which to house social enterprise. I figured that the existing menu of business structures (co-operatives, corporations, sole proprietorships, and partnerships) and nonprofit structures (nonprofit organizations and charities) presented plenty of options for social enterprises.

Again, I was wrong.

## The Quest Begins...

For me, the first hint of the need for something more came during the attempt to organize Abbotsford Recycling Industries Social Enterprise (ARISE). ARISE was conceived as a true triple-bottom-line (financial, social, environmental) venture. Its vision was to reclaim glass that was going all the way to China to be melted and rebrown. ARISE planned to melt local recyclable glass and recast it into high-end bathtubs, sinks, and wall blocks.

Marginalized people were to be employed in most aspects of the business and moved throughout the enterprise for optimal exposure to work experience. Financial literacy courses were to be offered to the employees. Social inclusion was to be a key value. Even heat generated by the operation would be held in underground grids to be used for local needs!

In the true spirit of collaboration, ownership of ARISE was to be shared five ways: a sole proprietorship (Sid Gould, the glass artist and concept originator); a corporation to supply refractory materials and expertise; a nonprofit community development agency (my own!) to provide social enterprise expertise; and two registered charities, one connected to marginalized workers and the other active in recycling.

ARISE required a legal structure that could address all the interests of these owners. It had to protect them adequately, provide them with governance powers, allow profit generation for all, and recognize the long-term nature of the venture.

*“Social enterprise” is not a legal expression in Canada. Without that recognition, social entrepreneurs have no hard & fast rules to follow regarding governance, the disposition of assets, the possibility of profit. Social enterprises cannot issue shares; rarely can they pay dividends.*

No single structural option – co-op, nonprofit, corporation, or charity – was equal to the task. After two years of research and business planning, ARISE never arose.

## Canada's Legal Cone of Silence

If, like me, you provide technical assistance to social enterprise, the story of ARISE is probably a familiar one. You will likely have experienced first-hand the uneasiness and confusion of charities and nonprofits as they consider or launch social enterprises.

This is largely because of the silence of federal and provincial legislation regarding social enterprise. “Social enterprise” is not a legal expression in Canada. There is no national or provincial social enterprise act or regulation that defines it or gives it legal form or structure. It is not addressed in the federal *Income Tax Act* as something distinct and worthy of unique treatment.

Without that recognition, social entrepreneurs have no hard and fast rules to follow regarding governance, the disposition of assets, the possibility of profit. Social enterprises cannot issue

shares; rarely can they pay dividends. The Canada Revenue Agency recommends that charities operating “unrelated businesses” form wholly-owned (taxable) corporate subsidiaries that must operate at “arms length” from the charity. There is no guidance on what “arm’s length” looks like. Instead, we have to draw pointers from a few scant case law decisions – and two of the best known decisions seem to contradict each other!<sup>1</sup>

Operators of social or community enterprises in Canada have been creatively working with the available legal structures for years. But a corresponding legislative or regulatory innovation has been virtually absent. The legal infrastructure has not kept pace with the growing sophistication of community enterprise.

Admittedly, it is difficult to customize legislation to the needs of social enterprises when they would sooner travel below public radar. Current legislation is so vague that social entrepreneurs fear revocation of charitable status or other repercussions, were their “true identity” to become public knowledge. They all (particularly charities) fear that they will get “caught” doing something “wrong” and be punished. This is particularly so when an enterprise is actually turning a profit.

That’s why so many nonprofit societies refer to their social enterprises as “projects.” It’s to keep the parent from being mistaken for an entity intended to achieve financial success. That is also why “projects” are often dubbed “social enterprises” after they fail. It’s finally safe to do so.

Imagine if sensible structural alternatives were available to allay all this fear of success! All the time and effort social entrepreneurs spend disguising their achievements would be

unleashed instead on the dilemmas that beset our communities. Positive and constructive energy would flow to the actual work of social enterprise, rather than the stealth and worry of structural issues. There would be more jobs created for the entrenched jobless, more chances for disenfranchised groups to participate in civic society, theatres filled to bursting by local arts organizations ... and way more attention and passion devoted to increasing sales of goods and services in the marketplace.

*Imagine if sensible structural alternatives were available to allay all this fear of success! All the time & effort social entrepreneurs spend disguising their achievements would be unleashed instead on the dilemmas that beset our communities.*

### **Structural Serendipity!**

Back to our story. For a time, a handful of ARISE supporters pushed for a legal structure that would recognize hybrid ownership. We watched with keen interest when the United Kingdom passed legislation in 2004 to inaugurate the Community Interest Company (CIC). Sid Gould penned a paper discussing the need for a similar structure in Canada. In the United States, in the meantime, Robert Lang championed a new twist on the limited liability company, the Low-Profit Limited Liability Company (L3C). We struggled for uptake from the Canadian sector ... and watched people’s eyes glaze over.

---

#### **Résumé : Entreprise sociale, illimitée**

« Entreprise sociale » n’est pas une expression légale au Canada. Il n’y a aucune loi ou règlement de « l’entreprise sociale » qui la définit ou lui donne une structure spécifique, des capacités et des limites. Les entrepreneurs sociaux n’ont donc aucun règlement clair par rapport à la gouvernance de ces organisations ou de l’utilisation de leurs actifs. Ils ne peuvent émettre des parts. Ils doivent s’assurer de fonctionner tout en gardant « leurs distances » des organismes de bienfaisance parrains. Il n’est même pas clair combien de profit elles peuvent faire.

Coopérative, OSBL, compagnies, organismes de bienfaisance – aucune de ces options ne répond à la gamme d’intérêts que plusieurs entreprises sociales tentent

de répondre. C’est pourquoi plusieurs entreprises sociales à succès sont déguisées comme des « projets ». Leur succès financier est une menace pour l’organisme parrain.

Imaginez comment une reconnaissance légale pourrait apaiser cette peur du succès! Imaginez l’énergie libérée pour le vrai travail de l’entreprise sociale. Imaginez les emplois qui pourraient être créés pour les laissés pour compte. Imaginez le temps et l’attention disponibles pour créer des biens et services de qualité pour le marché. C’est ce que le Royaume-Uni a vécu depuis qu’il a créé la Community Interest Company (2004) [Compagnie à intérêt communautaire]. C’est ce que les États-Unis pourraient atteindre avec leur

Low-Profit Limited Liability Company (L3C) [Compagnie à responsabilité limitée à faible profit].

Heureusement, il y a présentement un mouvement d’amorcé pour rattraper nos amis et voisins. L’expertise légale et le financement devient disponible pour commencer à élaborer une structure légale séparée pour l’entreprise sociale au Canada. Pour obtenir une telle décision politique fédérale, il faut toutefois une masse critique d’appui. Nous devons accumuler des données pour démontrer le besoin pour une telle loi et lui donner forme. Pour fonctionner, la définition légale « d’entreprise sociale » doit être une expression de la volonté et de la sagesse du secteur lui-même. ■

And then ... fast forward to early 2008. Through an odd twist of fate, and the generosity of the Muttart Foundation, I found myself invited to a think tank in Banff. The 3-day session was dedicated to exploring federal tax regulations affecting social enterprise. Among the 25 people there, were two folks from the United Kingdom who had direct experience with the unveiling and operation of CICs. Sitting next to me was the lawyer who penned the L3C legislation for the State of Vermont. While we sat in the Banff meeting room, the Vermont legislature passed the bill. (It became law soon after.)

Suddenly, the idea of creating a new legal structure specifically for Canadian social enterprise seemed not just important, but urgent. We were falling behind two of our greatest neighbours and mentors. Although the topic of Canadian legal reform fell outside the limits of discussion at Banff, the appetite for this monumental task had clearly increased. On the final morning of the conference, I was encouraged to present my arguments, using ARISE as a living example.

Then serendipity really kicked in. Charities lawyer Richard Bridge enthusiastically lent his support. Coast Capital Savings, which had invested in some earlier policy work relating to businesses operated by inmates of the federal corrections system (see "A Passion for Renewal: Co-operation and Commerce within Prison Walls," *Making Waves*, Vol. 18, No. 2, Summer 2007, pp. 5-8), immediately agreed to fund an exploration of the CIC and the L3C. Coast Capital also agreed to fund a paper that would posit the main provisions of a Made-in-Canada legal structure for social enterprise. Here are some of the results of that research.

### **CIC – The UK Innovation**

The CIC possesses some interesting features. It is simple and inexpensive to incorporate and features a low level of regulation. A dividend cap ensures that an adequate level of resources remains in the CIC to flow to "community benefit." (This concept is broadly defined, unlike Canada's four heads of charity: relief of poverty, advancement of education, advancement of religion, and community benefit.) The CIC has to file an annual report to ensure continued community accountability. An asset lock guarantees that upon dissolution, assets flow to CICs, charities, or other asset-locked entities. The net profits of CICs are taxed at corporate rates.

In too many cases inside and outside Canada, impediments to remuneration for the services of board members of nonprofit and charitable organizations force dedicated, skilled people (like founders) to choose between employment and governance. CIC directors can receive reasonable remuneration; founders

and CEOs can serve on the board. For CICs, these options are a powerful incentive to strive to attract the most suitable people to management and directorship positions. The longer-term plan is to build the CIC brand both for financiers and for consumers of the goods and services that CICs offer to the marketplace.

Within a year of the passage of the *Companies (Audit, Investigations and Community Enterprise) Act 2004*, over 360 CICs were formed. Now, the numbers approach 3,000. Work is underway to tweak some CIC features. This may include an increase in the dividend cap and more favourable tax treatment of investments in CICs.

### **L3Cs – The US Innovation**

CIC owners sometimes have to spend time explaining the nuances of the CIC form to financiers and the general public. No such explanation is required with the L3C. As I mentioned earlier, the L3C is not a new legal form but a variation on the long-recognized limited liability company (LLC).

*The managers of the L3C will have the freedom and flexibility of a for-profit, but with marching orders to ensure that they maintain their nonprofit souls.*

~ Robert Lang

To quote Robert Lang, "The LLC is an extremely successful business form that combines the best features of a partnership with the best features of a corporation: liability protection and the ability to sell itself in pieces." Unlike a corporation, LLC owners are called members (rather than shareholders). Instead of corporate bylaws, LLCs act under an operating agreement. All of that also applies to L3Cs.

Because of the flexibility of the operating agreement structure, each L3C member can enjoy different powers and privileges. This would prove valuable in situations of hybrid ownership (like ARISE). Likewise, members can be passive or directly involved in management, depending on the conditions of the operating agreement.

Because the L3C can structure tiered (or layered) investments, some investments can receive below market (or zero) rates of returns (foundations, socially responsible investors) while others can receive market rates of returns (traditional investors). Likewise, some investments (patient capital) can

*We currently have a patchwork, with lawyers & other advisors feeling that they are like Red Green, using duct tape to bind projects together.*  
~Richard Bridge, charities lawyer,  
Nova Scotia

---

### **Example 1** **How to Succeed Without Winning**

A large registered charity started a training and employment business as a service to its clients: marginalized individuals who wouldn't have been able to access work without patience and special attention to capacity-building. The social enterprise is operated as a project embedded within the charity.

Over time, the project's managers found that additional "mainstream" workers were needed in order to establish a quality of service delivery that could compete in the marketplace. Marginalized workers were then employed alongside skilled workers. This created new opportunities for social inclusion and contributed significantly to building the skills of the charity's clients.

This year, they have found that the project has reached such a high level of quality and efficiency that it earned more than \$80,000 in net profit. The guidelines of the Canada Revenue Agency on community economic development activities recognize "training businesses" that employ people for up to three years, and "social businesses" only for the disabled.<sup>2</sup>

Since this is neither a training business (because it offers long-term employment) nor a social business (because the staff are not disabled), the activity in question is beyond the bounds permissible to a charity. Ultimately, the parent organization was counselled to start a taxable corporation that would operate at "arm's length" from the charity but as its wholly-owned subsidiary.■

### **Example 2** **The Great Shell Game**

A small nonprofit society was formed to promote tourism within its region. Shortly after its formation, it concluded a management contract with local government to operate a large-scale venture. Currently, this contract is operated as a project within the nonprofit. The project's high-calibre promotional materials allude to the venture only, not the nonprofit.

The management contract has been a phenomenal success and now provides over 80% of the nonprofit's revenues. These revenues enable increased levels of tourism promotion and less reliance on government funding. So far, no acceptable legal structure has been found for the project to adopt. Things proceed very nervously forward under a nonprofit structure.

The nonprofit intentionally spends all its revenue from the project, understanding that such consistent and high profits run counter to its intended purpose. The practice of "spending to zero" affects the sustainability of the organization. There are few assets that can act as a buffer against budget shocks that may occur in the future.■

be given ownership interests that are subordinate to the other investments (e.g., traditional investors).

This feature enables the attraction of a broader variety and greater numbers of investors and other financial backers. The highest risk investment need not receive the highest rate of return. Each member is taxed according to his, her, or its own tax situation. (Many members will be legal entities, not people.) Corporations are taxed on L3C net profits at the corporate tax rate, individuals at the personal tax rate, charities at zero, etc.

The next steps in L3C development are to achieve federal acceptance (and sanction in more states), more tax incentives for participants, and the development of a roster of L3Cs.

Unlike the CIC, the L3C has no asset lock and no dividend cap. Branding has not been a priority to date. Lang asserts that the impacts of the L3C activities in themselves will be the most effective means for building awareness and confidence in the legal structure.

## **A Made-in-Canada Adaptation**

A separate legal structure for social enterprise in Canada could serve many purposes. Here are the main ones:

- Enable social enterprises to raise capital by issuing shares.
- Allow government to stimulate social enterprise specifically through incentives, such as favourable tax treatment.
- Clarify the limits of activity, particularly for charities.
- Create an option for sharing legal ownership and governance among groups with diverse legal structures.
- Increase the capacity of private businesses that already exceed the expectations of corporate social responsibility to further distinguish themselves as authentic, multiple-bottom-line enterprises.
- Enable the social enterprise sector to track its impacts (e.g., in terms of revenue and employment). This will help to attract public, private, and foundation funding to the sector.
- Introduce the social enterprise "brand" so the public can more readily recognize multiple-bottom-line ventures, and institutional buyers can recognize the benefits of procuring goods and services from social enterprises.

To achieve a policy decision such as this, however, we need critical mass. We have to collect data to demonstrate the need for such legislation. We know anecdotally, and Canadian charity lawyers confirm, that social enterprise currently makes do with a legal "patchwork." We need to discover the various approaches that social enterprises have taken in face of the structural limitations in Canada, collect the best characteristics that will assist

social enterprise performance and growth, and build the new possibility based on the feedback from the sector.

The UK is currently revisiting the characteristics of the CIC based on the experiences of the last four years. It would be valuable to know precisely the impact that CICs have had and not had in the UK to date.

We also need to discern the political and public policy environment surrounding this issue at the federal level. We require a detailed advocacy strategy that delineates the steps we must take in order to influence the federal government to create a separate legal structure for social enterprise in Canada.

And, of course, we need to hear from you!

## References

<sup>1</sup> In the case of the Alberta Institute on Mental Retardation, the Federal Court of Appeal (1987) adopted the United Kingdom's "destination test." The Institute worked with Value Village. All the revenue the Institute received was used for charitable purposes. Because the business income was used for charitable purposes, the court deemed the Institute a "related business." By contrast, in *Earth Fund v. the Queen* (2003), Earth Fund had been created to hold international internet lotteries in order to raise money for charities. The Court rejected the "destination test" and concluded that the Earth Fund was a commercial activity, but not a "related business." The court did not overturn the Alberta Institute on Mental Retardation case, but offered no practical guidance either. The legal meaning of "related business" remains murky.

<sup>2</sup> Currently, many training businesses routinely terminate the employment of marginalized people after three years in order to maintain the short-term employment requirement of the training business. This practice is undertaken solely to remain "inside the law." Nevertheless, it results in the deliberate "de-employment" of many people who cannot get mainstream jobs. The hard costs of this practice on the social safety net deserve consideration.



---

STACEY CORRIVEAU is Director of the BC Centre for Social Enterprise ([www.centreforsocialenterprise.com](http://www.centreforsocialenterprise.com)) and Community Economic Development Manager at Community Futures South Fraser in Abbotsford, B.C. Reach her at 604-864-5770 ext. 307 or by email to: [stacey@centreforsocialenterprise.com](mailto:stacey@centreforsocialenterprise.com).

To download a document that outlines the characteristics of the CIC and the L3C, as well as a Made-in-Canada proposal for social enterprise legislation, go to <http://www.centreforsocialenterprise.com/index.html>, items 1 and 2 on the homepage.

# Empowering people to transform their communities.

## Educating CED practitioners for over 25 years by:

- offering affordable graduate tuition.
- offering diverse peer learning educational models.
- delivering weekend and summer intensive programs with a practitioner and policy focus.

## M.S. in Community Economic Development:

- Manchester, NH Center
- Los Angeles, CA Center

## M.A. in CED Policy

## Ph. D. in CED (2010-2011)

## Offering online Graduate Certificate in Microfinance Management

## Offering unique M.S. specializations including

- Credit Unions and Cooperatives

**SNHU** School of Community Economic Development

*A School of Southern New Hampshire University*

603.644.3123 | [a.poore@snhu.edu](mailto:a.poore@snhu.edu)

[www.snhu.edu/CED](http://www.snhu.edu/CED)

**snhu.edu**  
on campus. on location. online.