Title: "A spotlight on Italy: The New Regulation of the “Social Enterprise”"
Author: Gregorio Salatino
Published in: *The Philanthropist*, European Philanthropy Journal
ISSN 2562-1491
Date: August 20, 2018
Original Link: https://thephilanthropist.ca/2018/08/a-spotlight-on-italy-the-new-regulation-of-the-social-enterprise/
Date of PDF Download: June 14, 2019

# A spotlight on Italy: The New Regulation of the “Social Enterprise”

By Gregorio Salatino

*This is the sixth article in a series about European philanthropy. The series is published as a collaboration between* The Philanthropist *and The Lawson Foundation.*

For some time now, a new player has been getting ready to “hit the stage” of the social economy in Italy.

The Italian government, with legislative decree no. 112 of July 3, 2017, adopted a new regulation for the category of “social enterprise” (“impresa sociale” in Italian).[1]

Since adopting it in 2017, legislators re-defined the features of the new social enterprise in a decree adopted by the Italian Council of Ministers on July 17, 2018. This decree – which is not yet in force[2] – aims to amend certain provisions of legislative decree no. 112 of July 3, 2017, mainly to address interpretative issues that arose in its first year. This shows, on the one hand, the uncertainty that still exists about social enterprise in Italy, and on the other hand, the constant effort to improve the regulation.

In any case, it is worth clarifying that the social enterprise is not a completely new legal entity in Italy. The first regulation of this kind of entity dates back to 2006. This older regulation fell short of expectations, and statistics have shown that very few used it to conduct their business.[3]

Given this scenario, the European Union strongly encouraged this recent change, singing the praises of social enterprise in official documents.

The communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions “Social Business Initiative,” adopted on October 25, 2011, reports that “The single market needs new, inclusive growth, focused on employment for all, underpinning the growing desire of Europeans for their work, consumption, savings and investments to be more closely attuned and aligned with ‘ethical’ and ‘social’ principles.” In this respect, the European Commission pointed out that social enterprises (and the social economy in general) have shown a high capacity in providing “innovative responses to the current economic, social and, in some cases, environmental challenges by developing sustainable, largely non-exportable jobs, social inclusion, improvement of local social services, territorial cohesion, etc."[4]

Thus, the time had come for social enterprises in Italy to play a role in driving a material change in the economic model that shapes the market.

However, what is a social enterprise?

It is an entity that brings together two items that are usually considered contradictory: commercial activity and social objectives. As far as Italy in concerned, this "contradiction" had been strongly stressed in the past, both by scholars and case law.

Both argued that organizations that pursued social objectives were not allowed – at the same time – to carry out commercial activities, otherwise the Courts would have reclassified them as *de facto* commercial companies for the purpose of declaring bankruptcy, if they were unable to pay their debts.

A few scholars, however, contested this view, arguing that "pure" commercial companies were (and are) fully allowed to distribute net profits. On the contrary, the organizations that pursue social objectives were (and are) characterized by the "non-distribution constraint" (i.e. they are not allowed – or allowed only in part – to distribute net profits).

This argument made clear that the central point of social enterprises (and, generally, of third sector organizations) is the non-distribution constraint. The fact that these organizations are not allowed to distribute net profits is the key argument to overcome the contradiction that an organization may, at the same time, carry out commercial activity and pursue social objectives.

Nowadays, this is a well-established principle in Italy.

However, debate on this issue ended only in 2006, when the first regulation of social enterprise entered into force (though such regulation had a lot of drawbacks, it was helpful to establish the principle that commercial activity and social objectives may coexist within the same organization).

We can now focus our attention on the new regulation of the social enterprise introduced in 2017.

First of all, the definition: according to Article 1 of Legislative Decree July 3, 2017, no. 112, the "social enterprise" may be any organization (regardless of the legal form – it can be an association or a foundation, a cooperative society, and even a commercial company) that carries out commercial activity in order to pursue, mainly and permanently, "civic, solidarity or social utility objectives."

Considering this definition, the profits that the organization makes through commercial activity shall be mainly invested to pursue the social objectives listed in the by-laws.

The experience of the previous regulation of 2006 showed that the main drawbacks were a too strict non-distribution constraint (the distribution of net profits to the shareholders of the organization was not allowed at all), the absence of any tax benefits, and the difficulty in raising finances.

In that scenario, why would an entrepreneur have invested in a social enterprise?

The entrepreneur, indeed, would not have been able to enjoy the profits of the organization and the shareholders of an organization would have experienced difficulty in raising funds. And there were not even tax benefits to counterbalance these drawbacks.

Many scholars maintained that the real advantage for the entrepreneur would have been the possibility to use the qualification of *impresa sociale* within the market. Such a “brand” would have increased the reputation of the organization in the eyes of third parties (clients, suppliers, other stakeholders, etc.). Experience, however, showed that this was not enough.

Consequently, with the new regulation, the Italian government is aiming to address the above three issues.

**The non-distribution constraint**

When dealing with the social enterprise challenges, the cornerstone is the non-distribution constraint. It is worth noting that the non-distribution constraint is fully consistent with the philosophy underlying the social economy: it is supposed to foreground the quality of the goods produced by the enterprise, leaving behind the individual profit of the shareholders.

In other words, while the ordinary entrepreneur focuses on gaining net profits (i.e. he or she will strive to produce the product at the very lowest cost and to sell it at the very highest price, in order to gain net profits), the social entrepreneur, instead, focuses more on improving the product (i.e. as the distribution of net profits is forbidden or strictly limited, they will be reinvested to have a product with higher quality).

Consequently, the strict non-distribution constraint provided for by the regulation of 2006 was not strange in the context of the social economy. However, tax benefits usually counterbalance the non-distribution constraint, which is something that was missing in the regulation of 2006.

In this respect, it is important to note that some years earlier, in the United Kingdom, the legislature regulated organizations that were similar to the Italian social enterprise, called community interest companies, without granting any tax benefits. To counterbalance the lack of tax benefits, the UK legislature provided for the possibility to distribute, though to a limited extent, the net profits to the shareholders.

No such possibility existed in Italy and, following an intense debate among scholars and other stakeholders, the Italian government realized that it was necessary to find a “fair” balance to avoid the strict non-distribution constraint. According to the new Legislative Decree July 3, 2017, no. 112, net profits and surpluses must be reinvested in the corporate business or in the net worth (as is common in the social economy). However, a certain amount of net profits and surpluses can now be allocated outside of the organization. This new scenario has thus allowed distribution to shareholders.

The social enterprise is allowed to allocate part of its net profits, in an amount less than 50% (and after deducting possible losses), to:

(i) Free capital increase (however, within the limit of the variation of the index that measures annually the prices for families of workers and employees as calculated by the Italian Statistic Agency); and/or

(ii) To distribution of net profits to the shareholders. These two options apply only to the social enterprises incorporated in the form of commercial companies; and/or

(iii) To free contribution in favour of organizations of the third sector other than social enterprises. Such free contribution shall be aimed at pursuing specific projects with social utility. This option applies to all social enterprises, regardless of the legal form of the organization (i.e. it applies to associations and foundations, to cooperative societies, and to commercial companies).

In addition, the social enterprise can contribute an amount not exceeding 3% of the yearly net profits to certain funds to be established according to Article 16 of Legislative Decree July 3, 2017, no. 112 (this article will deal with these funds later).

Hence, this is the “fair” balance elaborated by the Italian government: on the one hand, the shareholders can now, in part, enjoy the net profits; on the other hand, the fact that the regulation still contains a constraint to the distribution of net profits makes it consistent with the philosophy underlying the social economy, which, as already mentioned, does not look favourably on a completely free distribution of net profits.

**The new tax regime**

A clue to this philosophy also appears in the new tax regime applicable to the new social enterprise: only net profits that are reinvested in the corporate business or in the net worth of the social enterprise are excluded from the taxable income, while the net profits that are distributed to the shareholders do not benefit from this favourable treatment.

The decree adopted on July 17, 2018 by the Italian Council of Ministers clarified, on this point, that allocations of net profits through free capital increase (within the limit of the variation of the index that measures annually the prices for families of workers and employees as calculated by the Italian Statistic Agency) are not excluded from the taxable income.

As far as the tax regime is concerned, it is worth noting that specific measures have been adopted to attract investments in social enterprises in the “early stage.” Entrepreneurs that invest in social enterprises incorporated by no more than 36 months are eligible for a deduction in income tax in an amount equal to 30% of the investment in the corporate capital of social enterprises.

The decree adopted on July 17, 2018, however, amended the above provision, by stating that the deduction only applies with respect to those investments made after the entry into force of legislative decree no. 112/2017 and provided that the financed entity has acquired the qualification as “social enterprise” by no more than five years (the latter provision is aimed at aligning the regulation of social enterprise with the regulation of cutting-edge start-ups).

The maximum amount to which the deduction applies is equal to one million euros for each tax year, as far as private investors are concerned, while it is equal to 1.8 million euros for company investors. Such a deduction can be exercised within the third tax year after the tax year in which the investment was made. The investment, however, shall be kept at least for three years, otherwise the tax benefit will be lost. On this latter point, the decree adopted on July 17, 2018 stated that the investment shall be kept for at least five years (and not only three years).

Lastly, the decree adopted on July 17, 2018 pointed out that, in the case of a violation of the above tax regime, the social enterprise will lose the tax incentives and, eventually, the minister for labour may revoke the directors and auditors of the social enterprise and replace them with a public commissioner.

**New forms of financing**

The possibility to enjoy part of the net profits and the fiscal benefits has surely increased the appeal of social enterprise in the eyes of investors and entrepreneurs. However, given that social enterprise is included in the definition of non-profit organization, any social enterprise will also face the key issue for any non-profit organization: the difficulty of raising funds.

The sources of financing for non-profits usually include self-financing, donations, and grants from public authorities. In the context of economic crisis, such as the one Italy is going through, the usual sources of financing have decreased and, therefore, stakeholders need to find new ways to fundraise.

The Italian government seems to be aware of this issue and, in an attempt to mitigate it, has adopted, over the years, specific forms of financing for social enterprises. Legislative Decree July 3, 2017, no. 112 provides for two new measures for social enterprises.

The first concerns the establishment of certain funds for the promotion and financing of social enterprises. These funds will finance, *inter alia*, studies and research in the field of social enterprise and specific programs for the development of social enterprises.

Money for these funds will come either from contributions from social enterprises (which, though not obliged – as we have mentioned above – are allowed to allocate a part not exceeding 3% of the yearly net profits to such funds) or from the worth remaining after the dissolution of the social enterprises.

The second measure concerns the possibility for social enterprises to raise funds through portals for the collection of risk capital (so-called crowdfunding). This measure is rather new in Italy and only a few kinds of companies have so far been allowed to raise funds in this way[5] (consequently, by means of Legislative Decree July 3, 2017, no. 112, this new way of financing has also been extended to social enterprises).

In addition to the above two measures, it is worth mentioning a third that, though not included in Legislative Decree July 3, 2017, no. 112, has taken shape through a series of decrees adopted by the Italian Ministry of Economic Development in the years 2015-2017 (hence, while the government was working on the new regulation of social enterprises). According to such decrees, social enterprises can apply – until the relevant budget is exhausted – both for subsidized loans from the Revolving Fund to Sustain Enterprises and Investments (the so called “FRI”) in order to pursue specific investment plans, and for non-returnable grants from the Fund for Sustainable Growth. The overall amount of the budget of these funds is 223 million euro (200 million euro for the FRI and 23 million for the Fund for Sustainable Growth).

In conclusion, it appears that the new regulation for social enterprises consists of some remarkable steps forward when compared to the past government activity in this area. Of course, Legislative Decree July 3, 2017, no. 112 has entered in force very recently and, at this stage, there are no statistics to show its actual impact in the field of the social economy.

It is, however, clear that is has overcome many of the shortcomings of the regulation of 2006, which hindered the “take off” of social enterprises. Consequently, it is reasonable to hope for the future. Time will tell if these hopes are well-founded.

[1] Legislative Decree July 3, 2017, no. 112, published in the Italian Official Journal of July 19, 2017, no. 167.

[2] Please note that the decree adopted by the Italian Council of Ministers on July 17, 2018 will enter in force the day after its publication in the Italian Official Journal. As of the date of the last draft of this article (August 7, 2018), such publication has not yet occurred.

[3] According to the report of the National Institute of Statistics (ISTAT) concerning non-profit organizations in Italy dated December 20, 2017, until 2015 only few organizations chose the legal form of “social enterprise.” The number of such organizations is so low that in the above report they are included in the item “other legal entities.” Such items included social enterprises, ecclesiastical institutions, committees, and friendly societies. The overall percentage of all these different organizations is equal to 8%.

[4] See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on “Social Business Initiative” – “Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation,” adopted on October 25, 2011, COM (2011), 682.

[5] Other kind of companies that are allowed to raise funds through portals for the collection of risk capital are cutting-edge start-ups (according to Article 30 of Law Decree October 18, 2012, no. 179).