

# Social Enterprise and the power of collaboration

01 July 2019

by [Stephanie Wylde](#)

How does social enterprise contribute to the overall wellbeing of the New Zealand economy and what are the options for structuring these entities.

## The Social Enterprise Continuum

The impact that a social enterprise intends to have on society is central to their purpose and is ultimately their reason for their existence. As illustrated below, social enterprises sit between charities and for-profit commercial businesses on the business continuum.



(Theory: NESTA/Young Foundation 2011, Graphic: [Ākina Foundation](#))

## What is Social Procurement?

Closely related to social enterprises, is the concept of social procurement. Social procurement is the term used to refer to businesses utilising their buying power to achieve more than just economic benefits (i.e. more than just a cheap source of goods and services, the traditional 'cheapest quote'). The focus of social procurement is on "what" and "where" you source your goods and services from (i.e. from which businesses).

Social procurement involves businesses tapping into their vertical and horizontal supply chains to unlock benefits. There is opportunity for New Zealand businesses, which collectively spend over \$561 billion a year (Source: [Ākina Foundation](#)), to work together by purchasing from like-minded organisations, like social enterprises. This helps to deliver positive change by enabling social enterprises to generate revenue and continue to operate.

## **What is Impact Investing?**

A growing trend within the business community is impact investing. Impact investing is investing with the intention of generating a measurable and beneficial societal and/or environmental impact alongside a financial return. Impact investing can be seen as the process of putting your money to work in such a way that it helps to achieve something positive for society. This can include providing access to education, energy, water or healthcare; affordable housing; renewable energy; and other areas where long term social benefits can be realised such as projects that provide employment and training to those that may not otherwise have received them.

## **What entity structures are available for social enterprises and what are the relevant tax considerations?**

### **1. Limited liability companies**

Companies were traditionally set up to maximise shareholder returns. However, social enterprises are now including their social enterprise purpose/s in their constitution and operating policies. Limited liability companies are required to pay tax at the company tax rate of 28%. Companies with a charitable purpose are also able to register as a charity and receive income tax exempt status.

### **2. Incorporated charitable trust**

A charitable trust is required to have a charitable purpose and operate within the confines of that charitable purpose. A social enterprise needs to ensure the scope of their activities falls into, and adheres to, their intended charitable purpose. The Charities Act 2005 states that “Charitable purpose” must fall under one or more of these categories: “the relief of poverty, the advancement of education, the advancement of religion, or any other matter beneficial to the community”. Incorporated charitable trusts’ profits are not permitted to be distributed to private individuals. Trusts can register with DIA Charities Services and apply for donee status so that donations they receive are not taxed. Many organisations have worthy goals, however Charities Services can only register organisations as registered charities when they are confident that the organisation has exclusively charitable purposes.

Where a social enterprise is a registered charity an income tax exemption is available for both business and non-business income. To attract this exemption the business must be ‘carried out’ for charitable purposes and be a registered charity with DIA Charities Services as outlined above.

### 3. Incorporated societies

The Incorporated Societies Act 1908<sup>1</sup> enables members to form a society with a minimum of 15 members. Incorporated societies must develop a constitution or rules which set out their objectives. This option is sometimes chosen by social enterprises as it allows some flexibility in how the entity operates.

Incorporated societies are taxable on their income at 28% and can also access a concessionary income tax deduction of up to \$1,000. Societies that are not registered charities may still be entitled to an income tax exemption. This exemption applies to an association, club or society and relates to when amounts are derived mainly to promote an amateur game or sport. The Income Tax Act 2007 section CW46 states this exemption is available provided no part of the funds or income of the club are available to be used for the private pecuniary profit of any proprietor, member, shareholder or beneficiary. In reviewing what the main purpose of a sports club might be, the Commissioner of Inland Revenue would consider all the relevant circumstances, including the organisation's constitution and which activities were undertaken in a particular tax year.

<sup>1</sup> Currently being reviewed

## Donee status and tax benefits

Charities, and certain other not-for-profit organisations within New Zealand, are also eligible to be treated as a donee organisation, which means taxpayers can receive tax benefits for monetary donations they make to these organisations.

The tax benefits, which are direct benefits for the donors rather than the recipient donee organisations, include:

- a donation tax credit of 33.3% of the monetary donations made by an individual; and
- tax deductions if the monetary donation is received from a company or Māori authority. In both cases, the value of the tax benefit is capped (at the individual's taxable income for the year, or the company or Māori authority's net income for the year).

## What else should be considered?

### Access to capital

- One of the main issues for new businesses is the ability to access capital. A limited liability company may struggle gaining new funding as the social enterprise may have other objectives beyond returning a profit. Building the charitable purposes into the constitution and core policies will help, however the entity will still need investor support. Some investors are increasingly looking to make an investment in the "greater good" and diversify their portfolios. In recent years some of the world's biggest venture capitalists have put social enterprises on the map.

- In contrast to this, a charitable trust structure lends itself to approaching individuals and groups for philanthropic grants or donations if it has tax exempt status. It is difficult to attract private investors to share the risk given these entities do not return profits to shareholders and remain 'charitable' under the Charities Act 2005.
- There is growing contention that a new legal structure should be introduced for social enterprises given the number of other barriers social enterprises face, such as lack of funding, potentially limited financial and business experience, and immature support networks.

## What is the future for social enterprises?

There is growing recognition of the value social enterprises contribute to society as a result of their existence, including employing people, delivering social, cultural and environmental outcomes and not relying on government grants and donations. Organisations are increasingly demonstrating a commitment to a greater good, a 'purpose beyond profit'. The question is, are the incentives and structures adequate to encourage organisations to do both? Is there scope for improving entity structures and tax incentives available for social enterprises? We would love to know your thoughts.

### Case Study: Eat My Lunch

[Eat My Lunch](#) is an Auckland-based social enterprise which delivers a free lunch to children in low-decile schools in Auckland and Wellington for every lunch they sell (a buy-one, give-one model). They claim to have given over a million lunches to Kiwi Kids. A survey undertaken by Eat My Lunch found that 87% of schools saw better concentration in class and 62% saw improved attendance. Eat My Lunch have adopted the limited liability option, incorporating their company in October 2014. While the company aims to ensure that 'no child at school goes hungry, starting with kids right here in our own backyard', they are not a registered charity and there is no apparent mention of this goal in the company constitution.

To date Eat My Lunch have run three crowdfunding campaigns using the PledgeMe platform. The first campaign, in September 2015, attracted \$129k to get the project off the ground. Donors received a variety of rewards depending on donation amount.

The second campaign, in July 2016 raised \$817k through the issuance of bonds which are being progressively paid back on a six monthly basis.

The third campaign, in June 2019. Raised almost \$796k to finance the company's first store which is due to open in Britomart in July this year and to develop an in-house sales capability to drive growth, including overseas.

The founder of Eat My Lunch, Lisa King, advertised that potential investors did not seem to understand that the third campaign was an investment into the business, illustrating that there is scope to improve investor awareness of different funding models and platforms.