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Philanthropic foundations, business activities and competition rules: across the EU and US scenarios

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Abstract

Nearly every undertaking of a nonprofit exempt organization is a business. Yet, along with the increase in the business activities conducted by nonprofit entities, from both the EU and US scenarios arises the need for more certainty in the legal frameworks.

According to the functional approach taken by the European Court of Justice, indeed, public-benefit foundations with a tax-exempt status that engage in economic activities can be in conflict with EU competition law as soon as they offer goods and services on a market where competition exists (e.g., scientific research, education, art, health, welfare services), regardless of their nonprofit nature. Coherently, while the growing role of philanthropic foundations and nonprofit organizations as drivers of social innovation calls governments for a regulatory environment conducive to social businesses, it is also stressed that incentive policies must *not* distort the principles of competition.

Within the American pattern, rather, the tax-exemption of the nonprofit enterprise has been traditionally based upon the public benefit theory (i.e., reduction of government burden), until the 1950 Revenue Act assigned to the unrelated business activities tax the task to prevent unfair competition by non-profit firms.

However, over recent times the increasing involvement of nonprofit entities in business ventures came to challenge the traditional rationale for tax exemption of the nonprofit enterprise, raising the crucial question of whether nonprofits that operate commercial enterprises should play by the same rules as other businesses.

Given such converging scenarios, the article explores rationales and effects associated with the EU and US legal policies to prevent unfair competition by foundations and nonprofit organizations engaged in business activities. Ultimately, the research' s goal is to address the issue in the perspective of the *subsidiarity* model of governance, which strengthens the primary role of the civil society organizations in the fulfillment of social objectives and thus requires the application of competition rules to nonprofit enterprises be assessed accordingly.

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Contents

1. The nonprofit enterprise: an overview of the phenomenon at national and EU level

Nearly every undertaking of a nonprofit organization is a business, recent US studies indicate[1]. Unquestionably, in fact, the terms *enterprise* and *nonprofit* are no longer perceived as being contradictory[2] since leading American scholars have claimed that "*a nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees. […]. It should be noted that a nonprofit organization is not barred from earning a profit. Many nonprofits in fact consistently show an annual accounting surplus. It is only the distribution of the profits that is prohibited*" (so-called "nondistribution constraint")[3]. Thus, unfair competition by nonprofits is *not* a new phenomenon in the US scenario, where it surfaced as a public policy issue in the wake of the Mueller Macaroni Company case that involved New York University's law school in the late 1940s[4].

A few decades after, as soon as the welfare State came to be confronted with challenges[5] and the European Commission turned its attention to the "*economie sociale*" sector and to

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[1] B.R. Hopkins, Nonprofit Law, Nonprofit Governance: Law, Hoboken, N.J. : John Wiley & Sons, 2005, p. 139.

[2] *See*, in this regard, James C. Crimmins – Mary Keil, *Enterprise in the nonprofit sector*, Washington: Rockefeller Brothers Fund, 1983, pp. 6-7, noting that "profit-making enterprise is a legitimate and necessary way of sustaining a nonprofit organization in the exercise of its fundamental service role".

[3] Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 Yale L.J. 835 1979-1980, p. 838.

[4] *See* Susan Rose-Ackerman, Unfair Competition and Corporate Income Taxation, *Stanford Law Review* (May 1982), p. 1017. According to the Author, nonprofit enterprise in America developed slowly and without much furor until 1950, when a group of wealthy graduates donated the Mueller Macaroni Company to New York University (NYU) Law School. NYU claimed that since Mueller's profits were going to the university, a nonprofit organization, the profits were exempt from corporate income tax. Mueller's competitor, the Ronzoni Company, sued, arguing that the exemption gave Mueller an unfair competitive advantage in the pasta market. In response, Congress amended the income tax code in 1950 to eliminate this exemption. Henceforth, nonprofits would be permitted to retain an exemption only on 'related' business ventures" (e.g., the museum restaurant, the university bookstore, etc.).

[5] As noted by the EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe, of 12 September 2001, "in many EU countries, public authorities have for some decades made the sensible decision to use private not-for-profit social operators in the sphere of health and welfare. The current and future requirement to contain public spending (i.e. reduce its rate of increase) while needs are growing and becoming more complex, confirms the useful role and potential of these operators, which can be defined as "private not-for-profit providers of services of general interest".

the need to help this sector' organizations benefit from the EU free market[6], that concern arose alike in the European scenario.

In fact, the Commission pointed out by the late 1980s, "*the sector* […] *includes organizations which form part of the economy because they engage in productive activities, applying resources to satisfy needs. They may produce market goods and services (i.e. sold at a price that at least covers their production cost), or non-market goods and services (supplied free, or at a price unrelated to their cost, the difference being made up by non-market financing, membership fees, grants, donations, etc.). They are enterprises operating in competition with traditional forms of enterprise*"[7].

To date, while the nonprofit actors play an essential role in the economy and social innovation, such statements suit both European and American scenarios even more impressively.

At national level, not only Italian associations and foundations are allowed to carry out business activities[8], but recent data mark the increase in the economic activities carried out by nonprofit organizations, along with the dramatic growth of the sector[9] and major

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[6] Commission of the European Communities, Businesses in the "Economie Sociale" sector. Europe's frontier-free market. Communication from the Commission to the Council, SEC (89) 2187 final, 18 December 1989. On the crisis of the welfare state, *see* also the Introduction to the EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe of 12 September 2001, noting that "It is no coincidence that the Committee has decided to draw up this opinion, which stems from, and must be seen in relation to, the cross-roads of developments that are gradually defining, framing and enhancing what we call the "European social model". The main features of these promising trends can be summarised as follows: […] b) b) the resolve to manage the growing complexity of our modern societies as well as possible; to make the most of their many and varied assets, values, strengths, and wealth of commitments and contributions; to address their pluralism as an asset rather than as a handicap; and thus to provide the widest possible scope for "organised civil society" to assume its role and responsibilities".

[7] Commission of the European Communities, Businesses in the "Economie Sociale" sector.

[8] Subject to the non-distribution constraint and to specific rules provided by the law: *see* below.

[9] The Italian National Institute of Statistics (ISTAT) 9th General Census of Industry and Services registered 301,191 non-profit institutions active in Italy as on 31st December 2011, encompassing 186,038 public-benefit entities and 115,153 mutual entities, in particular: 201.004 associations non recognized as legal persons (66,7 percent), with a growth of +28,7 percent since ISTAT Census of 2001; 68.349 associations with legal personality (22,7 percent), with a growth of +9,8 percent since ISTAT Census of 2001; 11.264 social cooperatives (3,7 percent), with a growth of +98,5 percent since 2001; 6.220 foundations (2,1 percent), with a growth of +102,1 percent since ISTAT Census of 2001; and 14.354 other nonprofit institutions (4,8 percent) – e.g. ecclesiastical entities, mutual aid societies, committees - with a growth of + 76,8 percent since ISTAT Census of 2001. The sector of activity with the largest number of institutions is culture, sport and recreation (with over 195,000 institutions), followed by social services (i.e., welfare) and emergency prevention (with over 25,000 institutions), labor unions and business and professional associations (with over 16,000 organizations), education and research (with over 15,000 institutions), health (with over 10,900 institutions), and other sectors (e.g., development and housing, environment, law advocacy and politics, religion, philanthropic intermediaries and voluntarism promotion, etc.). In economic

changes occurred in the legal scenario as of the 1990s[10].

In fact, out of the 301,191 nonprofit organizations registered in 2011 by the National Institute of Statistics 9th General Census of Industry and Services[11], 92,132 entities qualify as *market producers* - i.e., entities that sell most or all of their output at prices that are economically significant[12] -, engaging in market production primarily in the sectors of

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terms, in 2011 the total revenue of Italian nonprofit organizations amounted to 63.9 billion Euros; the total expenditure amounted to 57.3 billion Euros. In terms of source of funding, private funding is the prevailing source of funding, with over 259,000 entities receiving more than 50 percent of their income from members' contributions, trading, donations, bequests, and financial investment and assets; instead, the entities receiving public funds account for 41,760. Overall, to date the nonprofit organizations represent 6.4 percent of legal-economic bodies active in Italy, with over 951,000 employees and over 4.7 million volunteers, thus being the most dynamic sector in the 10-year period between the two ISTAT censuses, with a growth registered in 2001 higher than that of the business sector (+28.0 percent in terms of legal-economic bodies, and +39.4 percent in terms of employees versus +8.4 percent and 4.5 percent, respectively). *See*, for an in-depth analysis of the Italian nonprofit sector, G. BARBETTA, 2011.

[10] Indeed, until the beginning of the 1990s, the Italian legal framework for nonprofit organizations comprised a few general provisions set forth in the Book I, Title II, of the Civil Code of 1942 (titled "legal persons"). By allowing discretionary governmental control over the creation activities and dissolution of nonprofit organizations (particularly foundations), the original Civil Code' regime imported an enlightenment-derived mistrust toward mortmain risks and political diffidence toward intermediate social bodies. By the end of the 1990s, yet, the original legal framework went through a series of major reforms, including: the 2000 reform of the procedure for the recognition of legal persons; the proliferation of special laws which provided for the creation of different types of foundations as a result of the privatization of formerly state-controlled bodies (e.g., foundations of banking origin, music foundations, cultural foundations, university foundations, privatized public charitable institutions etc.); and the enactment of an heterogeneous series of tax measures with substantive aims (e.g., the Law no. 49 of 1987 on non-governmental organizations, the Law no. 266 of 1991 on volunteer organizations, the Law no. 381 of 1991 on social cooperatives, the Law no. 383 of 2000 on associations of social promotion, up to the Legislative Decree no. 460 of 1997 on noncommercial bodies and nonprofit organizations of social utility and the Legislative Decree no. 155 of 2006 on social enterprises). Eventually, following an amendment of 2001, article 118, paragraph 4, of the Italian Constitution has established that "*the state, regions, metropolitan cities, provinces and municipalities shall promote the autonomous initiatives of citizens, both as individuals and as members of associations, in carrying out activities of general interest, on the basis of the principle of subsidiarity* (so-called horizontal subsidiarity), thus shaping a new relationship between public and private actors in the promotion of welfare. Consistently with such principle, a new proposal for reform of the third sector organizations (not including political associations, labor and trade unions, and professional associations) is currently being discussed by the Italian Parliament in an aim to implement, even through tax incentives and supporting measures, a systematic legal framework that should promote the active and responsible participation of citizens in pursuit of the common good, while enhancing the growth and job creation potential of the social economy and third sector organizations (C-2617 of 22 August 2014). For a detailed analysis of the Italian legislative developments, *see* R. RAMETTA,

[11] Under the ISTAT Census, the nonprofit institutions are defined as "*legal or social entities created for the purpose of producing goods and services, whose status does not permit them to be a source of income, profit, or other financial gain for the units that establish, control or finance them*".

[12] According to the System of National Accounts (SNA1993) and to the European System of National and Regional Accounts (ESA95), Nonprofit Institutions are classified in a) *market producers*, if they sell most or all of their output at prices that are economically significant; b) *non-market producers* if they provide most of their output to others free or at prices which are not economically significant. Nonprofit Institutions engaged in *non*-market production are NPIs that must rely principally on funds other than receipts from

culture sport and recreation, social services, education and research, economic development and housing, and health.

Several laws, within the currently fragmented legal scenario, provide for specific set of rules on the economic activities carry out by nonprofit entities.

Above all, under the Legislative Decree no. 460 of 1997 on nonprofit social-utility organizations (so-called "ONLUS"), all entities qualifying as "*nonprofit social-utility organization*" for tax benefits purposes[13], can carry out business activities in their institutional fields and directly related activities if *non*-dominant (i.e., activities which do not outnumber the institutional activities, and do not generate revenue for an amount exceeding 66 percent of the total expenses), subject to the non-distribution constraint[14].

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sales to cover their costs of production or other activities. Therefore, less than 50 per cent of NPI costs of production are covered by sales.

[13] I.e., associations, committees, foundations, cooperatives and other private entities which pursue exclusively social benefit purposes in one or more of the sectors laid down by the law, namely: social assistance and social-health assistance, health care, charity, education, training, amateur sport, protection and promotion of historic and art property, protection and improvement of nature and environment, protection of culture and art, protection of civil rights, scientific research of particular public interest carried out by foundations, universities or research centers. *See* article 10, para. 1, lett. a)-b), and para. 2-2bis-3-4, Legislative Decree 4 December 1997, no. 460. According to the "ONLUS" law, the *social utility* requirement will be met in two situations:

1. when the entity performs its activities in the fields of social assistance and social health care; charity; protection and promotion of historic and art property; protection and promotion of nature and environment; protection of culture and art (to the extent public funds are used); and scientific research of particular social interest conducted by foundations, universities or research centers.
2. when the entity performs its activities in the fields of health assistance, instruction, education, amateur sport, protection of culture and art (carried out without using public funds); and promotion of civil rights, and such activities are performed in favor of disadvantaged people or members of foreign communities (with respect to humanitarian aids).

Thus, in the former case, a social utility purpose will automatically be presumed to exist, and therefore qualification as an ONLUS will not be subject to the verification of the disadvantaged status of the beneficiaries; whereas in the latter case the social utility purpose must be verified in relation to the disadvantaged status of the beneficiaries.

[14] Art. 10 Legislative Decree 4 December 1997, no. 460. The law carefully defines the non-distribution constraint. In particular,

- article 10, para. 2, under d), prohibits all distributions, both directly or indirectly, of profits, surpluses, funds, reserves or capital during the life of the organization, except for distributions provided for by the law or distributions made in favor of other ONLUS forming part of the same structure. Pursuant to article 10, para. 6, sales to members/founders/board members/donors at a discounted price, as well as purchases at a price above market standards, remunerations of board members above the thresholds provided by law and wages to employees increased over 20% in relation to market standards, are considered to be indirect distributions of profits; moreover,
- pursuant to article 10, para. 1, lett. e), ONLUS organizations must use their profits or surpluses to carry out the social utility activities and other activities directly related to them. Moreover, pursuant to article 10, para. 1, lett. f), in case of a dissolution for any reason of an ONLUS, its assets must be entirely transferred

Furthermore, according to article 3, paragraph 1, of the Legislative Decree no. 153 of 1999, the foundations of banking origins[15] are allowed to carry out exclusively *related* business activities aimed at achieving the foundations' mission – i.e., the pursuit of social benefit goals and economic development within their local communities - in their major sectors of activity[16]. The conduct of such business activities is subject to the non-

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to another ONLUS for no consideration, or allocated to public welfare purposes, save as otherwise provided for by law.
In terms of fiscal reliefs, pursuant to article 150 of the Italian Tax Code (Presidential Decree no. 917/1986), the exercise of institutional activities of the ONLUS organizations will not constitute commercial activity under any circumstances, and the income arising from the exercise of ancillary activities directly related to the goals of the entity will not be taxed. In addition, further tax benefits are provided for by the VAT Decree no. 633 of 1972.

[15] Legislative Decree of May 17, 1999, no. 153. The foundations of banking origins originated from the transformation of pledge and saving banks under the banking reform law n. 218 of 1990 ("Amato" law), which began the reorganization of the Italian banking sector through: 1. the transformation of the savings banks and public law credit institutions - banking organizations originally established as (private or public) nonprofit institutions pursuing the "public interest" and having strong philanthropic aims - in joint-stock banking companies, and 2. the parallel "re-creation" of foundations to continue with the philanthropic goals of the original banks. To date, although widely varying in size and activities, the 88 foundations of banking origins share a core identity as nonprofit, private and autonomous legal entities that engage exclusively in socially-oriented activities and economic development within their local communities. *See*, for a more detailed examination of the Italian foundations of banking origins, NUZZO, 1999; BARBETTA, 2008. According to latest data reported by the Italian Savings Banks Association (*see* ACRI, *Annual Report* 2013), on 31st December 2012 the book value of the net assets of foundations of banking origins amounted to 42.1 billion Euros, accounting for 82.7% of their total assets (equal to 51.0 billion Euros). In the same year, the total revenues and gains of the foundations amounted to 1.5 billion Euros, including: dividend income from the spin-off banks (445 million Euros, 29 percent), dividend income from investments other than in the spin-off banks (305 million Euros, 20 percent), portfolio management activities (399 million Euros, 26 percent) and income from the other financial instruments (104 million Euros). In the same year, the funds disbursed for institutional activities (including the special funds for voluntary activities pursuant to law no. 266/1991) amounted to 965,8 million Euros. Of these, the funds disbursed for *grant-making* philanthropic activities accounted for 88.4%; the *operating* philanthropic activities carried on directly by the foundations of banking origins accounted for 9.4%, whereas the funds assigned to instrumental enterprises aimed at pursuing the institutional goals of the foundations amounted to 4.3%. In 2012, most of grants went - among the 21 "eligible" sectors stated by the law- to the "art, cultural activities and heritage" sector (accounting for 31,6% of funds). This was followed by "education learning and training", "social assistance", "research", "voluntary activities philanthropy and charity", "local development", "public health" and other sectors. Overall, the assets held by the 88 foundations of banking origins account for a large part of the total assets of the Italian foundation sector (as close to the majority of Italian foundations have small dimensions, with total assets less than 500,000 Euros and only 16.4% reporting endowments equal to or more than 5 million Euros: *see* ISTAT, 2009), with the largest of them currently ranking among the world's top foundations (e.g. Cariplo Foundation).

[16] On the "eligible" sectors, within which the foundations can choose up to five "priority" sectors, *see* art. 1, para. 1, letter c-*bis*), Legislative Decree no. 153 of 1999, and artt. 153, para. 2, and 172, para 6, Legislative Decree no. 163 of 2006: i.e., 1. family and related values; 2. youth training; 3.education, learning and training, including the purchase of publishing products for schools; 4. volunteer activities, philanthropy and charity; 5. religion and spiritual development; 6. assistance to the elderly; 7. civil rights; 8. crime prevention and safety; 9. food safety and quality agriculture; 10. local development and low income housing; 11. consumer protection; 12. civil protection; 13. public health, preventive and

distribution constraint[17], to separate bookkeeping rules and to the operational standards set forth in the law as well as in the recently approved, voluntary but binding, Charter of the Foundations[18].

The foundations of banking origin can carry on business activities either directly, or through *ad-hoc* "instrumental" companies, which operate exclusively for the direct fulfillment of the institutional purposes within the priority sectors[19]. Rather, the foundations of banking origins are explicitly forbidden from carrying out banking functions[20], as well as from undertaking any form of either direct or indirect financing, grant-making or any other funding toward any for-profit entity and whichever business enterprise, except for the case of instrumental enterprises mentioned above, leisure entertainment and news media cooperatives, social enterprises and social cooperatives[21]. Accordingly, the foundations of banking origins can hold controlling shares exclusively in "instrumental" companies which have as their exclusive scope the management of instrumental enterprises[22].

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rehabilitative medicine; 14. sport activities; 15. addiction prevention and recovery; 16. psychic and mental pathologies and disorders; 17. scientific and technological research; 18. environmental protection and quality; 19. art, cultural activities and heritage; 20. public or public utility works; 21. Infrastructures. Pursuant to article 9, para. 1, Legislative Decree no. 153 of 1999, the foundations of banking origins qualify as non commercial entities for corporate income tax-exemption purposes , even if they pursue their mission by means of instrumental enterprises.

[17] *See* art. 8, para. 3, Legislative Decree no.153 of 1999.

[18] E.g., a reasonable use of the available resources; the choice, among the fields of operation permitted by the law, of those sectors with the highest social impact; a careful and sound management of endowment and expenditures; transparency and disclosure of granting decisions; the best use of the resources available and the effectiveness of projects undertaken, etc.

[19] *See*, for the legal definition of "instrumental enterprise", art. 1, para. 1, lett. h), legislative decree no. 153 of 1999. Although most activities carried out by the foundations of banking origin fall into the *grant-making* approach, the number of foundations that use funds to run their own projects according to the *operating* approach has been increasing over recent times. Moreover, over recent years, the search for innovative philanthropic tools favored the implementation of the so called *mission-related investments*. These are investments that further the socially-oriented and economic development purposes of the foundations, following the venture-philanthropy approach. Examples of investments in this style are the investments in property development societies, motorways, airports and other local infrastructures, social housing, scientific research, etc.

[20] By December 2012, of the 88 foundations, 22 no longer held shares in their original spin-off banks; 53 had a minority holding; 13 foundations of small dimensions held more than 50%, in accordance with the exemption for foundations whose net assets have a book value lower than 200 million Euros or are operating in special statute regions, to be allowed to maintain control of their original banks (art. 4 of the Law Decree no. 143/2003 converted into Law no. 212/2003, which substituted paragraph 3-*bis* of art. 25 of Legislative Decree no. 153/1999).

[21] Article 3, para. 2, Legislative Decree no. 153 of 1999.

[22] Article 6, para. 1, legislative decree no. 153 of 1999.

Finally, the Italian law on social enterprise (Legislative Decree no. 155 of 2006) establishes that «*all private organizations, also including those of the Fifth Book of the Civil Code, which carry out a stable and main*[23] *economic and organized activity with the aim of production or exchange of goods or services of social utility for the common interest, and which meet the requirements of articles 2, 3 and 4, can be considered as social enterprises*»[24].

Regardless of the legal form (e.g., cooperative, company, association, foundation etc.)[25], thus, *any* civil society organization can obtain the social enterprise status, provided that the following conditions are met:

- performing an entrepreneurial activity[26] of production of *social utility* goods and services. Pursuant to the law, the *social utility* requirement is satisfied if goods or services produced are *related* to one or more of the social utility sectors listed by the law[27]. Moreover, independently from the nature of the sector of activity, an enterprise is eligible for the social enterprise status if it is aimed at the integration in the workplace of underprivileged or disabled people[28];
- pursuing *public benefit* aims: that is, not restricting (even indirectly) the delivery of goods and services to shareholder, members or participants[29];
- acting under the *non-distribution constraint*, namely: 1) social enterprises have to invest their income in the core business or in increasing their assets[30]; and 2) they cannot distribute (not even indirectly) neither profits, however they may be named, nor parts of

[23] I.e., the income has to be at least 70 percent of the total income of the organization.
[24] Article 1, para. 1, Legislative Decree no.155 of 2006.
[25] *See* Introductory Note to the Proposal of Law no. 3045. *Compare* A. FICI, *The new Italian Law on Social Enterprise,* 2006, p. 2, "*Italian law is a general law on social enterprises and not a particular law on a specific (or unique) form of social enterprise*".
[26] According to the definition of enterprise laid down by article 2082 of the Italian Civil Code, «*The entrepreneur professionally carries out an economic and organized activity with the aim of production or exchange of goods and services*».
[27] Article 2, para. 1, Legislative Decree no.155 of 2006. I.e., i.e., welfare, health, welfare-health, education instruction and professional training, environmental and eco-system protection, development of cultural heritage, social tourism, academic and post-academic education, research and delivery of cultural services, extra-curricula training, support to social enterprises.
[28] Article 2, para. 2 and 4, Legislative Decree no.155 of 2006. I.e., .e., the activity is carried out by employees, of whom at least 30 percent are underprivileged or disabled.
[29] Article 1, para. 2, Legislative Decree no.155 of 2006.
[30] Article 3, para. 1, Legislative Decree no.155 of 2006.

the assets to directors, shareholders, members, employees or collaborators[31]. Moreover, for-profits entities are explicitly forbidden from controlling a social enterprise[32].

In order to assure the effective pursuance of the goals of common interest, the governance of the social enterprise is subject to fundamental standards of correctness and efficiency of management[33], transparency[34], non-discrimination[35], participation[36] and worker protection[37].

Beyond the national scenario, philanthropic foundations are "*important actors in the European economy*"[38]. In fact, according to data, approximately 110,000 public-benefit purpose foundations are active in a number of key areas benefiting European citizens and the EU economy (e.g., education and research, social and health services, arts and culture), not only through making their resources available to citizens or organizations for a specified purpose but also, to an increasing although varying degree across Europe, running their own operations and programs (e.g. private universities, hospitals, museums,

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[31] Article 3, para. 2, Legislative Decree no.155 of 2006. For the notion of *indirect* profits distribution, *see* also Article 3, para. 3, Legislative Decree no.155 of 2006: for example, according to the law, it is considered indirect profits distribution to reward directors more than 20% of the remuneration awarded by firms that operate in identical or analogous sectors and conditions.

[32] Article 4, para. 3, Legislative Decree no.155 of 2006.

[33] *See* article 8, para. 3, Legislative Decree no.155 of 2006: "*the founding act must lay down specific requirements of reputation, professionalism and impartiality of the members of the organs"*. Moreover, according to article 11, in certain cases, social enterprises are required to appoint one or more persons for the control of management conduct and the audit of accounts.

[34] *See* article 5 Legislative Decree no.155 of 2006, which requires the founding acts drawn up in public (notary's) form, sets a minimum content for them, and prescribes their deposit in the public registry of firms; article 7, para. 1, that imposes the use of the expression "social enterprise" in the name of the organization; furthermore, article 10, that obliges social enterprises to draw up and deposit in the public registry of firms annual accounts (financial balance sheets) and the social report (social balance sheet), that is a document which should represent and give evidence to the pursuit of the goals of common interest by the social enterprise.

[35] *See* article 9 Legislative Decree no.155 of 2006, which provides for the non-discrimination rule in the admission and exclusion of members and entitles rejected candidates (and excluded members) with the right to appeal to the assembly of members.

[36] *See* article 8 Legislative Decree no.155 of 2006, stating that the election of the majority of organ members cannot be reserved to external subjects (i.e. non members), and article 12, that prescribes workers' and customers' involvement of in the activity of social enterprises. In particular, according to the article 12, para. 2, "involvement" refers to any process, including information, consultation or participation, through which workers and customers can influence decisions of the enterprise, at least those directly regarding working conditions and the quality of goods and services.

[37] *See* article 14, para. 1, Legislative Decree no.155 of 2006, stating that the economic and legal treatment of workers of social enterprises cannot be inferior to that provided for by the applicable contracts and collective agreements.

[38] Commission Staff Working Paper, *Impact Assessment*, accompanying the document Proposal for a Council Regulation on the Statute for a European Foundation (FE), SWD(2012) 1 final, p. 8.

research institutes, etc.)[39].

The regulation of foundations engaging in economic activities is featured by different approaches across EU countries. Indeed, some Member States allow foundations to carry out economic activities – including both related and unrelated economic activities - without special restriction (e.g., the Netherlands); other States (e.g. Spain) rather restrict the foundations' economic activities for reasons of creditor protection concerns or protection of the foundation' assets, and allow foundations to carry out only economic activities that are related to the public benefit purposes (i.e. directly contributing to the furthering of the public-benefic purposes: e.g. a museum running a bookshop or a foundation in the health sector running a hospital), or unrelated economic activities that are complementary to them; eventually, other Member States only allow some very specific economic activities listed in law (e.g. Malta)[40].

In an effort to balance flexibility for foundations operating on a cross-border basis, on the one hand, and concerns of public authorities and third parties on the other, the recent Proposal of a Statute for a European Foundation[41] would allow the public-benefit foundation to freely engage in economic activities, including unrelated economic activities[42], provided that any profit was exclusively used in pursuance of the foundation' public benefit purposes and that economic activities *unrelated* to the public benefit purpose were only be permitted *up to a threshold*, which would be determined in the Statute[43]. In order to distinguish the income arising from related and unrelated activities,

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[39] Commission Staff Working Paper, *Impact Assessment*, pp. 9-10.

[40] As regards tax law, most Member States allow national public benefit purpose entities to carry out related economic activities without losing their beneficial status, and exempt the income from these activities. Rather, the profits of unrelated economic activities are usually subject to income tax in order to avoid an unfair advantage in competition with taxable enterprises. *See* for more details Feasibility Study, pp. 88 et seq.

[41] For a detailed description of the Statute for a European foundations, *see* Commission Staff Working Paper, *Impact Assessment*, pp. 28 et seq.

[42] I.e., independent delivery of goods or services which do not directly serve the public benefit purpose of the foundation, e.g. a museum running a petrol station next door, foundations organizing concerts to raise funds.

[43] This approach is based on the principle that allowing only public purpose related activities would deprive foundations of an important source of income that could be channeled back to the public benefit activities. Indeed, as stated by the Commission Staff, "*this option would give European Foundations more choice in the types of activities they can carry out, by allowing them to benefit from more ways of increasing their funds. They would thus be able to engage in economic activities directly contributing to the furthering of the public benefit purpose, but also in non-related economic activities (not directly serving the public benefit) as long as the profits were used in pursuance of the public benefit purpose*. (…) *By requiring that any profit from economic activities be channeled to the public benefit purpose and by restricting unrelated*

the latter would need to be presented separately in the accounts[44].

In addition to philanthropic foundations, the many different forms encompassed within the cluster of civil society organizations (i.e. cooperatives, mutual societies, associations, foundations etc.), are regarded as "*key stakeholders in the social economy and social innovation*", accounting for 10 percent of all European businesses, with 2 million undertakings and 6 percent of total employment in 2009[45].

By the early 1980s, thus, the increasing role of business activities carried out by nonprofit organizations in the European economy (particularly, in the field of providing services such as healthcare, social services, education, etc.) has driven new legislative efforts which have ultimately led to the Commission' Social Business Initiative of 2011 and the Social Investment Package of 2013, aimed at creating a favorable regulatory environment for social enterprises[46].

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economic activities through a threshold, this option should provide a sufficient guarantee to donors and all other parties concerned that the profits of European Foundations will be spent on public benefit purpose objectives. These requirements, also in the light of the non-distribution provisions of the public benefit purpose foundation, should respond to concerns relating to misuse of the Statute". *See* Commission Staff Working Paper, *Impact Assessment*, pp. 62 et seq.

[44] Commission Staff Working Paper, *Impact Assessment*, pp. 62 et seq., noting that "the choice of whether to allow a European Foundation to carry out only economic activities that are related to the public benefit purposes it pursues or to allow also unrelated economic activities (subject to certain conditions) has important tax law implications. In fact, if the Member State concerned grants tax benefits only to domestic foundations that carry out only related economic activities whilst the European Foundation is allowed by its Statute to carry out also unrelated economic activities, the consequence in some Member States could be that all income that the European Foundation derived from the unrelated economic activities would be subject to taxation according to the general rules of the Member States concerned (i.e. tax benefits would not be applicable to this income). In order to distinguish the income arising from related and unrelated activities, the latter would need to be presented separately in the accounts. In other Member States with stricter laws, the consequence could be even more severe and could result in the refusal of the Member State concerned to grant tax benefits at all to the European Foundation. In other words the European Foundation could lose all the tax benefits that would normally be granted to it" .

[45] According to the EESC Opinion on the 'Diverse forms of enterprise' (Own-initiative opinion), 2009/C 318/05, of 10 July 2008, the social economy accounts for 10 % of European enterprises as a whole, with 2 million enterprises, and 7 % of total wage-earning employment. The cooperatives have 143 million members, the mutual societies 120 million, and associations bring together 50 % of the EU population. On the essential role of the social economy enterprises in the European economy, with particular regard to services of general interest, *see* EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe of 12 September 2001; European Parliament Resolution on Social Economy of 19 February 2009. More recently, *see* EESC, The Social Economy in the European Union, 2012.

[46] 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. Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation*, COM(2011) 682 final, p. 5. *See* also European Parliament Resolution of 19 February 2009 on Social Economy

According to the Commission's broadly conceived definition, a social enterprise (or social business) is "*an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involve employees, consumers and stakeholders affected by its commercial activities*"[47]. Thus, three key dimensions mark the social enterprise:

1. a social purpose (i.e. the common good or general interest);
2. a commercial activity;
3. a participatory governance[48].

Coherently, the term "social enterprise" covers a widely diverse range of private enterprises (mainly identified with cooperatives, mutual societies, associations and foundations), providing social services and/or goods and services to vulnerable persons

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(2008/2250(INI), stating that "*the social economy plays a key role today in preserving and strengthening* [the European social and welfare model] *by regulating the production and supply of numerous social services of general interest*". Basing on this premise, the EU Parliament "*recognises that the social economy can prosper and develop its full potential only if it is able to benefit from suitable political, legislative and operational conditions*"; EESC Opinion on 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 - Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation, COM(2011) 682 final, of 23 May 2012, noting that "*social enterprises should be supported by virtue of the key role that they can play as drivers of social innovation, both because they introduce new methods for providing services and action aimed at improving people's quality of life, and because they promote the creation of new products to satisfy society's new needs. In particular, the EESC would like to highlight the enormous potential that social enterprises offer for improving labour market access and working conditions especially for women and young people, as well as for various categories of disadvantaged workers*"; EESC Opinion on Social entrepreneurship and social enterprise of 26 October 2011. *See* also Commission of the European Communities, Businesses in the "Economie Sociale" sector, noting that "organizations in the cooperative, mutual and non-profit sector are active agents in the economy and society of all European countries, and in most of their fields the part they play is by no means negligible".

[47] 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.

[48] For more details on the criteria laid down by the European Commission for identifying a social enterprise, *see* the EESC Opinion on 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. *See* also the EESC Opinion on the 'Diverse forms of enterprise', stating that "Although this term is not employed in every EU country and others use the expressions 'third sector', 'third system', 'solidarity economy', or others, all these terms describe enterprises that 'share the same features in every part of Europe'": namely, as described in the text, a social purpose with the prime objective of meeting the needs of persons rather than providing returns to investors of capital, and similar features of organization and operation.

(e.g., access to housing, health care, assistance for elderly or disabled persons, inclusion of vulnerable groups, child care, access to employment and training, dependency management, etc.); and/or businesses with a method of production of goods or services with a *social* objective (e.g., social and professional integration via access to employment for people disadvantaged in particular by insufficient qualifications or social or professional problems leading to exclusion and marginalization) but whose activity may be outside the realm of the provision of social goods or services.

2. Striking a balance between social business and competition rules: the EU Court of Justice approach

As described above, the recent contributions to the drafting of the Social Business Initiative point to the need for a favorable economic and regulatory environment considering the specific characteristics of social enterprises, in order to promote the role of social economy and that of the nonprofit players that support it[49].

At the same time, yet, they stress that "*the creation of firms in the social economy sector must not upset the structure of existing markets by providing unfair competition for private-sector firms, working under the same conditions and selling goods and services below market prices"*[50]. In other words, incentive policies must *not* distort the principles of competition[51].

Article 107(1) of the Treaty on the Functioning of the European Union (thereinafter, TFEU), indeed, establishes that "*save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which*

[49] EESC Opinion on 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, recommending, in particular, "that initiatives be taken to enable individual Member States to grant tax relief on undistributed surpluses so as to help consolidate the equity of social enterprises".

[50] EESC Opinion on The Social Economy and the Single Market, of 2 March 2000.

[51] EESC Opinion on 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 – Creating a favorable climate for social enterprises, key stakeholders in the social economy and innovation COM(2011) 682 final, of 23 May 2012.

distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market"[52].

Accordingly, the following elements are assigned a key relevance in the application of EU State aid rules: 1. the concept of undertaking, 2. State resource (i.e., the imputation of the financing measure to the State); 3. the selectivity of the measure and 4. its potential effect on competition and trade within the EU.

1. *The concept of undertaking*: based on article 107 TFEU, the State aid rules generally only apply where the recipient is an "*undertaking*".

In this respect, the Court of Justice has constantly defined undertakings as *entities engaged in an economic activity*, regardless of their legal status and the way in which they are financed[53]. Moreover, to clarify the distinction between economic and non-economic activities, the Court of Justice has held that *any* activity consisting in *offering goods and services on a market* is an *economic* activity[54].

Thus, the qualification of an entity as *undertaking* depends entirely on the *nature of its activities*. As a result:

- the status of the entity under national law is *not* decisive: for example, an association or a sports club may be regarded as an *undertaking* within the meaning of Article 107(1) of the Treaty whether it carries out an economic activity;
- the application of the State aid rules does *not* depend on whether the entity is set up to generate profits: non-profit entities can offer goods and services on a market too[55].

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[52] Pursuant to the Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid, aid amounting to less than EUR 200 000 per undertaking over any period of three years is not caught by Article 107(1) of the Treaty. As of 2012, the general *de minimis* Regulation is integrated with the Services of general economic interest *de minimis* Regulation introduced by the Almunia package (*see* text below), by which public service compensation amounting to less than €500 000 per undertaking over three fiscal years is deemed *not* to constitute State aid. This threshold is higher than the one in the general *de minimis* Regulation, based on the consideration that an SGEI provider incurs costs which are directly associated with its public service obligation under the entrustment act. The aid element in the compensation is therefore presumably much lower than the amount actually granted, and the Commission assumes that a €500 000 compensation does not affect trade in the internal market.

[53] *See* Joined Cases C-180/98 to C-184/98 Pavlov and Others [2000] ECR I-6451.

[54] Case 118/85 Commission v Italy [1987] ECR 2599, paragraph 7; Case C-35/96 Commission v Italy [1998] ECR I-3851, paragraph 36; Joined Cases C-180/98 to C-184/98 Pavlov and Others, paragraph 75.

[55] Joined Cases 209/78 to 215/78 and 218/78 Van Landewyck [1980] ECR 3125, paragraph 21; Case C-244/94 FFSA and Others [1995] ECR I-4013; Case C-49/07 MOTOE [2008] ECR I-4863, paragraphs 27 and 28.

Whether this is not the case, non-profit providers remain of course entirely outside of State aid control;

- an entity that in itself does not provide goods or services on a market, is *not* an undertaking for the simple fact of holding shares (even a majority or controlling shareholding), in an undertaking providing goods or services on a market, when the shareholding gives rise only to the exercise of the rights attached to the status of shareholder or member as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset[56]. However, if the control of the shareholding in a company (banks and others) leads to direct or indirect *influence on the management of the company*, therefore the entity would be regarded as an *undertaking* within the meaning of article 107 TFEU. In this respect, in fact, the Court of Justice looks at the existence of a controlling share and other functional, economic and organic links[57].

2. *State resource*: only *economic advantages* (benefits) granted directly or indirectly *through State resources* can constitute State aid within the meaning of Article 107 of the Treaty[58]. Rather, advantages financed from private resources may have the effect of strengthening the position of certain undertakings, but do *not* fall within the scope of State aid rules.

For the purpose of State aid rules, an advantage is *any* economic benefit which an undertaking would not have obtained under normal market conditions (i.e. in the absence of State intervention)[59] and which improves the financial situation of the recipient, regardless of the cause and objective of the State intervention[60], as well as of the form of the measure[61]. Indeed, according to the Court of Justice case-law, the transfer of State resources may take many forms: e.g., direct grants, loans, guarantees, tax credits and

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[56] Case C-222/04 Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA and Others [2006] ECR I-289, paragraphs 107-118 and 125.

[57] *See* Case C-480/09 P AceaElectrabel Produzione SpA v Commission [2010] ECR paragraphs 47 to 55; Case C-222/04 Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA and Others [2006] ECR I-289, paragraph 112.

[58] Joined Cases C-52/97 to C-54/97 Viscido and Others [1998] ECR I-2629, paragraph 13, and Case C-53/00 Ferring [2001] ECR I-9067, paragraph 16. See also Case C-379/98, PreussenElektra v Schleswag [2001] ECR I-2099.

[59] Case C-39/94 SFEI and Others [1996] ECR I-3547, paragraph 60; Case C-342/96 Spain v Commission [1999] ECR I-2459, paragraph 41.

[60] Case 173/73 Italy v Commission [1974] ECR 709, paragraph 13.

[61] Case C-280/00 Altmark Trans [2003] ECR I-7747, paragraph 84.

benefits in kind, and the fact that the State does not charge market prices for certain services.

Thus, the notion of *aid* under the Treaty is a broad concept that includes not only positive benefits, such as subsidies, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect (i.e., relief from economic burdens)[62].

Consequently, a tax exemption as well as a tax reduction granted to certain undertakings can be regarded as State aid for the purposes of article 107 TFEU whenever, although not involving the transfer of State resources, such measures place the recipient undertakings in a more favorable financial position than other taxpayers.

3. *Selectivity of the measure:* as stated above, to fall within the scope of Article 107(1) TFEU, the financing of a measure by the State or through State resources must favor "*certain undertakings or the production of certain goods*". In this respect, the State measure (e.g., tax benefit) is considered to be a *selective* measure where it does not apply to *all* economic operators within a State member on an equal basis[63], but is rather accorded on the basis of the undertaking's legal form and of the sectors in which that undertaking carries on its activities[64].

4. *Effect on competition and trade within the Union*: in order to be caught by article 107 of the Treaty, the State resource must "*distort or threaten to distort competition"* and *"affects trade between Member States*". In this respect, according to the case-law of the Court of Justice:

- such effects generally imply the existence of a *market open to competition*. Therefore, where markets have been opened up to competition either by Union or national legislation or *de facto* by economic development, State aid rules apply;
- it is *not* necessary that the aid has a real effect on trade between Member States and that competition is actually being distorted. Rather, it is sufficient only to examine whether

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[62] *See*, in particular, Case C-143/99, para. 38; Case C-501/00, para. 90; Case C-66/02, para. 77.

[63] S*e*e Case C-66/02, para. 99; Case C-148/04, para. 49.

[64] Neither a large number of eligible undertakings (which can even include all undertakings of a certain sector), nor the diversity and size of the sectors to which they belong, provide grounds for concluding that a State initiative constitutes a general measure of tax or economic policy, if not all economic sectors can benefit from it. *See* Case C-143/99 Adria-Wien Pipeline [2001] ECR I-8365, paragraph 48.

that aid is liable to affect such trade and distort competition[65]. In particular, according to the Court of Justice, when aid granted by a Member State *strengthens the competitive position* of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid[66]. Indeed, public support is liable to distort competition even if does not help the recipient undertaking to expand and gain market shares. It is enough that the aid allows it to *maintain* a stronger competitive position than it would have had if the aid had not been provided;

- aid measures can also have an effect on trade where the recipient undertaking does *not* itself participate in cross-border activities. In such cases, in fact, domestic supply may be maintained or increased, with the consequence that the opportunities for undertakings established in other Member States to offer their services in that Member State are reduced[67];

- there is no threshold or percentage below which trade between Member States can be regarded as not having been affected (i.e., the relatively small amount of aid or the relatively small size of the recipient undertaking does not *a priori* mean that trade between Member States may not be affected)[68].

In several cases, however, the Commission concluded that activities having a purely *local* character do *not* affect trade between Member States (e.g., local hospitals aimed exclusively at the local population, local museums unlikely to attract cross-border visitors, local cultural events, whose potential audience is restricted locally).

Basing on this complex framework, for the first time in 2004 the European Court of Justice reviewed the issue of whether national tax exemptions for public-benefit foundations, which undertake economic activity, can be in conflict with EU competition law, after that the Italian Supreme Court suspended its judgment in a case involving a foundation of banking origin, and sent the file to the European Court of Justice[69]. The

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[65] Case C-372/97, para. 44; Case C-66/02, para. 111; Case C-148/04, para. 54.

[66] Case C-66/02, para. 115; Case C-148/04, para. 56.

[67] *See*, in particular, Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH [2003] ECR I-7747.

[68] Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, paragraph 81.

[69] Case C-222/04. The Italian Supreme Court claimed that it was unclear if the ownership and the management of substantial shareholding in companies (banks and others) by foundations of banking origin

Court concluded that if a foundation offers goods or services in the market *in an area where a competing market exists* (e.g. in the fields of scientific research, education, art or health) - either carrying on that activity on the market directly or managing controlling shareholding in a company and having actual influence on the management of the company -, it has to be qualified as an *undertaking*, notwithstanding the fact that the offer of goods or services is made without profit motive; as such, the foundation is subject to the application of EU state aid rules.

Along with tax benefits granted to public-benefit foundations, the tax treatment of cooperatives came also under investigation of the EU Commission, following complaints from private competitors, which demanded that certain provisions regarding the tax treatment of cooperatives be considered State Aid under the EU competition rules[70].

More broadly, the "functional" approach taken by the European Court of Justice - i.e., foundations, associations and other non-profit organizations can be *undertakings* if they carry out an *economic* activity, either directly or through another legal entity as influential shareholders - has a crucial impact on the support of the social economy sector.

Increasingly, in fact, nonprofit organizations engage in economic activities (i.e. offer goods and services) to fulfill their social aims on markets where competition exists such as the areas of health and welfare services[71], scientific research, education, art, etc.: depending on national tax laws, they might enjoy tax advantages, which could be

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could be seen as *economic* activity, and therefore could involve the application of competition rules, which would make tax benefits granted to foundations unlawful "State aid", according to the EC Treaty.

[70] Joined Cases C78/08 to C80/08. *See,* for an in-depth analysis of the topic, María Pilar Alguacil Marí, Tax treatment on co-operatives in Europe under the State aid rules, in Johann Brazda, Markus Dellinger, Dietmar Rößl (Hg), Genossenschaften im Fokus einer neuen Wirtschaftspolitik, 2012, p. 1091, noting that "The accusation to the special regime of taxation for cooperatives is not new, as cooperatives are conferred a beneficial status, which could be considered unfair competition for the rest of undertakings. The question, though old, acquires a new interest in view of the confluence, in recent times, of several circumstances: On the one hand, many European laws about co-operatives are more permissive today than before, allowing them to compete more openly on the market. On the other hand, there is a greater intensity in the emphasis placed by the European Commission in recent years in the control of State aid of a fiscal nature".

[71] So-called "social services" or "private not for-profit providers of services of general interest": e.g., retirement homes, centers for children and adults with disabilities, youth protection agencies, educational social activities, hostels and social rehabilitation centers, day nurseries, child-minding centers, health care centers, social centers, not-for-profit private care centers and home help, nursing and medical assistance, home assistance, carer and other services. *See*, on the topic, the EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe of 12 September 2001.

regarded as potentially conflicting with EU competition law.

3. The US legal pattern for nonprofit enterprise

The nonprofit enterprise is all but an unknown phenomenon in the American scenario. Indeed, leading studies point out, "*nonprofits have pursued enterprising ways of earning revenues since the time of the Pilgrims. The first nonprofits developed at the grassroots level, often as offshoots of community or church groups. When such groups discovered that money that couldn't be earned by passing the collection plate could be raised at the church bazaar, nonprofit enterprise was born* "[72].

According to latest available data of the Statistics of Income Division of the Internal Revenue Service (hereinafter, IRS), the number of returns filed by *private foundations* with the IRS amounted to 92,990 in 2011, encompassing 85,500 non-operating foundations and 7,490 operating foundations[73], overall reporting $79,435 millions in total revenue. The number of information returns filed by *nonprofit charitable organizations* — i.e., the organizations described in the Section 501(c)(3) of the IRC[74] other than private foundations, religious organizations, and organizations with receipts under $25,000 — amounted to 274, 287 in 2011[75].

Overall, nonprofit organizations engage in a wide range of income-producing enterprise

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[72] James C. Crimmins – Mary Keil, Enterprise in the nonprofit sector, Washington: Rockefeller Brothers Fund, 1983, p. 18, further adding that "over time, these enterprises have evolved into solid business ventures, such as thrift shops, bookstores, coffee shops, and gift shops that contribute varying levels of income to nonprofit organizations".

[73] SOI, Bulletin Historical Table 16: Nonprofit Charitable Organization and Domestic Private Foundation Information Returns, and Exempt Organization Business Income Tax Returns: Selected Financial Data, 1985-2011, 2014.

[74] I.e.: Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

[75] SOI, Bulletin Historical Table 16.

activities (e.g., universities charge tuitions, hospitals collect fees, etc.). In particular, in 2011, the nonprofit charitable organizations reported $1.194.199mill. in program revenue service (out of $1.647.905mill. total revenue declared). Such program revenue is income earned directly from program activities: that is, fees collected by organizations in support of their tax-exempt purposes, and income such as tuition and fees at educational institutions, hospital patient charges, and admission and activity fees collected by museums and other nonprofit organizations or institutions.

To date, the federal government approach to the issue of unfair competition by nonprofit organizations engaged in economic activities falls in with the traditional scheme:

"*an exempt organization may carry on a business or activity which competes with other businesses without subjecting itself to taxation so long as business is substantially related to exempt purpose of organization"*[76].

Under the Internal Revenue Code, in fact, organizations that are exempted from taxation under Section 501(c)(3) can engage in virtually unlimited commercial activities, for the code makes the distinction that exempt status is based on the *primary* purpose of the organization ("*organized and operated exclusively for…*"), *not* on its activities. The only requirement for the retention of tax-exempt status is that the surplus generated by the business activities be used for tax-exempt purposes ("*no part of the net earnings of which inures to the benefit of any private shareholder or individual"*).

Shortly, thus, the income is tax-free to the extent that an activity is "*substantially related*" to the organization's tax-exempt purpose (e.g., theater admissions, university tuitions, etc.). By contrast, net income from "*unrelated*" business activities is subject to the unrelated business income tax (UBIT), which generally taxes such income at ordinary corporate (or trust) tax rates.

In particular, pursuant to Sections 511, 512(1) and 513(1) of the Internal Revenue Code (thereinafter, IRC), tax-exempt organizations (including the realm of charitable organizations described under IRC § 501(c)(3), trusts and private foundations[77]) are

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[76] Anateus Lineal 1948, Inc. v. U. S., W.D.Ark.1973, 366 F.Supp. 118.

[77] Some exempt organizations are not generally subject to the UBIT rules, simply because they are not allowed to engage in any active business behavior. The best example of this is private foundations, the operation of unrelated business would trigger the application of the excess business holdings restrictions. Indeed, under Section 4943 of the IRC, foundations, together with their disqualified persons, are prohibited from owning more than 20% interest in any business enterprise; the limitation is increased to 35% if

subject to income tax liability, similarly as are taxable organizations, if they engage in commercial activities that are *unrelated* to their exempt purposes.

The *unrelated business taxable income* of otherwise tax-exempt organization is the organization's gross income, less allowable deductions, derived from *any trade or business* (that is, any activity performed for the production of income from the sale of goods or performance of services), *regularly carried on* by the organization (that is, the activities manifest a frequency and continuity and are pursued in a manner similar to comparable commercial activities of taxable organizations), the conduct of which is *not substantially related* (aside from the need of such organization for income or funds or the use made of the profits) to the exercise or performance of the organization' exempt purposes, based on an examination of the relationship between the business activities generating the income and the accomplishment of the exempt purposes (e.g., the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy)[78].

Thus, for an activity of a tax-exempt organization to be taxable as generating "*unrelated business taxable income*", the activity must:

- constitute a trade or business,
- be regularly carried on,
- be unrelated to the exempt purpose of the organization, and
- not be done for the convenience of the organization's members, students, patients, officers or employees[79].

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effective control of the enterprise an be shown to be held by anyone other than the foundation and its disqualified persons. *See* B. R. Hopkins, p. 141.

[78] I.e., a trade or business is related to the exempt purposes only where conduct of the business had a substantial casual relationship to the achievement of those purposes, meaning that the production or distribution of goods or the performance of the services must contribute importantly to the accomplishment of the exempt purposes. *See* Louisiana Credit Union League v. U.S., C.A.5 (La.) 1982, 693 F.2d 525: to determine whether a tax-exempt organization is carrying on a trade or business for unrelated business income tax purposes, the court must look to see whether that institution is engaged in extensive activity over a substantial period of time with the intent to earn a profit.

[79] *See* St. Luke's Hospital of Kansas City v. U.S., W.D.Mo.1980, 494 F.Supp. 85.

4. The public benefit theory: traditional rationales and current issues at stake

Historically, the tax-exemption of the nonprofit enterprise has been based upon the theory that "*the exempt entity confers a public benefit, a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues*."[80]. Thus, "*the Government is compensated for its loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from public funds*"[81]. By doing so, in fact, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government[82].

This rationale is closely tied to the key role of nonprofit organizations in the US scenario: indeed, American leading scholars point out, *"nonprofit organizations in our society undertake missions that are, in other countries, committed to business enterprises or to the state. Here, we importantly, if not exclusively, rely on the third sector to cure us, to entertain us, to teach us, to study us, to preserve our culture, to defend our rights and the balance of nature, and, ultimately, to bury us. And we rely on private philanthropy – third sector financing – to support activities that other nations support with public funds*"[83].

In 1950, in response to complaints of unfair competition by Mueller' competitors[84], Congress amended the Internal Revenue Code, which, until then, followed a *destination of income* test under which income, whatever the source, could be earned tax-free if profits were dedicated to a charitable purpose. Congress indeed passed the Unrelated Business Income Tax (UBIT), which rather required nonprofits to pay federal taxes on income obtained from activities *unrelated* to the reason they received tax-exemption and *regularly* carried on. Effect of the 1950 Revenue Act, thus, was to abandon preexisting

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[80] *Bob Jones*, 461 U.S. at 587.

[81] H.Rep. No. 1860, 75th Cong., 3rd Sess. 19 (1938) [McGlotten v. Connally].

[82] *See* E.K. Taylor, Public Accountability of Foundations and Charitable Trusts. New York: Russell Sage Foundation, 1953, pp. 77 et seq.

[83] John G. Simon, "Research on Philanthropy". A talk at the 25th Anniversary Conference of the National Council on Philanthropy, Denver, Colorado, November 8, 1979.

[84] In 1948, a group of alumni donated the Meuller Macaroni Company to New York University's law school. As an educational institution, NYU enjoyed nonprofit status, and persuaded a court that the company should also be tax-exempt on the grounds that the company' profits were to be used to support the university's educational mission.

doctrine that destination of income was more important than its source, and, thereafter, *source of income* was the important consideration in determining exemption for income tax purposes[85].

Essentially, according to the Senate Report, "*the problem at which the tax on unrelated business income is directed is primarily that of unfair competition*"[86] between tax-exempt organizations and for-profit commercial enterprises. In particular, the objective of the unrelated business income tax rules was to prevent unfair competition by placing the unrelated business activities of nonprofit organizations on the same tax basis (*level playing field*) as those of their non-exempt competitors[87], regardless of whether such business activities were operated directly as divisions of charitable organizations, or operated indirectly as separate incorporated feeders.

Although nonprofit enterprise is as old as the nonprofit sector itself[88], yet until the 1980s no one was concerned about the commercial activities of nonprofits[89]: first, the nonprofit sector was small; secondly, the commercial activities of nonprofits were limited in scope; and third, as long as taxes were low and there were few regulations, the privileges enjoyed by nonprofits did not give them a decisive advantage over for-profits[90].

By the late 1970s, along with cutbacks in government funding at the federal, state and

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[85] Iowa State University of Science and Technology v. U.S., Ct.Cl.1974, 500 F.2d 508, 205 Ct.Cl.339. *See also* Ocean Cove Corp. Retirement Plan and Trust v. U.S., S.D.Fla.1987, 657 F.Supp. 776: "Unrelated business income tax" is tax intended to reach a nonprofit organization's attempt at expanding with use of tax-exempt funds, when *source of funds* is unrelated to purpose behind granting of organization's exempt status" (emphasis added).

[86] Senate Report No. 2375, 81st Cong., 2nd Sess., 1950, pp. 28-29.

[87] *See* People's Educational Camp Soc. Inc. v. C.I.R., C.A.2 (N.Y.) 1964, 331 F.2d 923, certiorari denied 85 S.Ct. 75, 379 U.S. 839, 13 L.Ed.2d 45, stating: Congressional purpose behind 1950 amendments, prohibiting extending exemption to "feeder" organizations and imposing tax on "unrelated business income" of certain organizations otherwise exempt from taxation, was to prevent organizations with tax exempt status from competing unfairly with ordinary, taxed business entities. *See* also National League of Postmasters of U.S. v. C.I.R., C.A.4 1996, 86 F.3d 59: Tax on otherwise tax-exempt organization's unrelated business taxable income is designed to restrain unfair competition by otherwise tax-exempt organizations engaged in profit-making activities without unnecessarily discouraging benevolent enterprise.

[88] Classic nonprofit businesses are museum gift shops, university bookstores, junior league cookbooks, etc. *See* James C. Crimmins – Mary Keil, p. 23, emphasizing that "until very recently, most nonprofit enterprises were somewhat casual in nature. They often started as services to patrons, clients, or constituencies and were not expected to contribute substantial income to the organization".

[89] In response to growing complaints about unfair competition arising from the special privileges granted to nonprofit organizations, the U.S. Small Business Administration has identified unfair competition as "an issue for the 1980s": *see* Unfair Competition by Nonprofit Organizations with Small Business: An Issue for the 1980s, 3rd ed., Washington, D.C.: Small Business Administration, 1984.

[90] *See* James T. Bennet – Thomas J. DiLorenzo, Unfair competition: the profits of nonprofits, Boston: Hamilton Press, 1989, p. 2; James C. Crimmins – Mary Keil, p. 19.

local levels, nonprofit organizations have begun to look beyond traditional funding sources[91] and to develop new income-producing enterprises ranging from enterprises *closely related* to the organization's program (e.g., orchestra ticket sales, university tuitions, museum admissions), to business activities basically *unrelated* to the organization's program (e.g., real estate development, investments in any type of business, etc.)[92].

Crucially, thus, as a result of the growing involvement of nonprofit organizations in business activities and the subsequent commercial nonprofit competition with small business firms, several questions came to challenge the US legal pattern for nonprofit organizations and the traditional rationales for nonprofit tax-exemption. As surveys of profit-making activities of nonprofits reported in the early 1980s, "*it is no longer (and never really has been) a question of* whether *enterprise has a place among nonprofits, but what kind of role it can and should play, what kinds of limits and constraints should be placed on it, what kinds of benefits and incentives can be applied to encourage its growth*"[93].

In the following years, the unfair competition issue and its negative effects on the economy were in-depth explored by eminent scholars, concluding that "*when two types of organizations engaged in identical commercial activities are treated differently under the law, there is unfair competition. This condition is particularly evident in nonprofit organizations that operate under different rules and regulations than private, for-profit*

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[91] I.e., government and foundations grants, corporate gifts and individual donations, fees and admissions, etc. As indicated by James C. Crimmins – Mary Keil, p. 67, "nonprofits have traditionally delivered goods and services deemed necessary (education, community development) or desiderable (ballet, museums) for the public good. The government, in order to further the public good, has underwritten these efforts by providing direct and indirect subsidies through grants, tax exemptions, and incentives to private giving, some of which are extended to certain kinds of nonprofit enterprises. With the reduction of direct government subsidies, funding for these efforts in the nonprofit sector is potentially compromised. To continue to operate, nonprofits will either have to pursue other sources of donated funding or *create* revenue themselves, through enterprise, to replace lost subsidies". *See* also James T. Bennet – Thomas J. DiLorenzo, pp. 18 et seq.

[92] James C. Crimmins – Mary Keil, p. 23, stating: "the museum gift shop that sold postcards could also sell reproductions, posters and tote bags. It could branch our into mail order, reaching a much larger clientele. It could sell the use of its name for consumer articles ranging from clothing to coffee pots. It could offer museums tours around the world and from there start a full-scale travel service". *See* also Lester Salamon, The Invisible Partnership: Government and the Nonprofit Sector, Bell Atlantic Quaterly (Autumn 1984), p. 5: "forced by budget cuts to become less governmental, nonprofit agencies have responded not by becoming more charitable, but by becoming more commercial".

[93] James C. Crimmins – Mary Keil, p. 66.

seeking firms. Government has granted nonprofits special privileges that give them significant advantages in the marketplace. They are exempt from federal, state and local taxation and from many regulations; they receive preferential postal rates and other subsidies; and they often have preference in obtaining government grants and contracts. These exemptions and privileges reduce the production costs for nonprofits and give them an edge over their private competitors"[94]. Examples reported were abundant: museums selling merchandise through mail order catalogs and gift shops, colleges and universities operating travel and tour business and engaging in commercial laboratory testing, YMCAs competing with private fitness centers, nonprofit hospitals running catering services, pharmacies sell hearing aids, etc. In this respect, according to the study's perspective, "*the issue is not competition* per se*, but unfair competition. Whenever a nonprofit produces goods and services in competition with for-profits, simple equity demands that the nonprofit be subject to the same tax laws, pay the same postal rates, and be governed by the same regulations as its for-profits-seeking counterparts*" [95].

Further concern have focused on the ineffectiveness of the UBIT tax in achieving its goal of reducing unfair competition, due to a number of factors: the problem of the courts and the IRS in determining whether a commercial activity is substantially *related* to the primary exempt-purpose[96], the numerous exemptions from UBI tax allowed by the law, the large *non* reporting of UBI earnings by tax-exempt organizations engaging in UBIT activity and the consequent substantial tax loss. According to IRS data[97], in 2011, 45,384 charitable and other types of tax-exempt organizations filed unrelated business income tax returns: of these, 21,660 reported unrelated business taxable income; 23,724 did *n*ot report unrelated business taxable income. Overall, the unrelated business taxable income totaled $142 million, while the income tax unrelated business income tax in the same year amounted to $364 million.

In conclusions, as a result of the growing convergence of the nonprofit and for-profit

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[94] James T. Bennet – Thomas J. DiLorenzo, p. 1.

[95] James T. Bennet – Thomas J. DiLorenzo, p. 3. According to Authors' view, the solution to the unfair competition is to require nonprofits to form for-profit subsidiaries when they engage in commercial activities: "this would place both types of organizations on a 'level playing field'".

[96] *See*, in this regard, James C. Crimmins – Mary Keil, p. 19, noting: "the university bookstore now has to decide whether selling toothpaste is related or unrelated to the function of the university: do clean teeth serve the purposes of higher learning?"

[97] SOI, Bulletin Historical Table 16.

sectors[98] - major examples include the conversion of hospitals from nonprofit to for-profit status, joint ventures with private investors, the use of royalty agreements between exempt organizations and taxable entities -, the rationale for tax exemption and other privileges for nonprofits that rely for support solely on receipts for the services they provide is at stake even in current US scenario[99].

5. Social businesses and competition rules: the need for a differentiated approach

As described above, like their US counterparts, EU foundations and other social economy organizations are active in a competitive market. Many nonprofit entities, in order to fulfill their social tasks, exercise activities in economic areas where commercial firms operate (e.g., health and welfare services); the latter consider that they are exposed to a form of unfair competition. In many Member States, thus, governments have been questioning, especially from the tax side, whether exemptions granted for social services from competition rules are warranted, thereby triggering a debate which is still in full swing[100].

As a result, notwithstanding dramatic differences in the historical and legislative developments, both EU and US patterns for nonprofit organizations are faced by a crucial issue: "*the problem - and it is a real problem - is the future that lies ahead from the angle of (...) competition law*"[101].

In this respect, the American studies questioning the common rationale for the tax privileges accorded to nonprofits engaged in commercial activities[102], and the European Court of Justice significantly converge on an extremely broad concept of *economic*

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[98] *See* Burton A. Weisbrod, The Voluntary Nonprofit Sector: An Economic Analysis. Lexington, Mass.: Lexington Books, 1977; M. R. Fremont-Smith, Governing Nonprofit Organizations. Federal and State Law and Regulation. Cambridge, Mass.: Belknap Press of Harvard University Press, 2004, p 15.

[99] Henry Hansmann, The Role of Nonprofit Enterprise, Yale Law Journal (April 1980), p. 884.

[100] EESC Opinion on The Social Economy and the Single Market, of 2 March 2000; EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe.

[101] EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe of 12 September 2001.

[102] James T. Bennet – Thomas J. DiLorenzo, p. 1.

activity, which considers an economic activity to be *any* activity consisting of supplying goods and services in a given market by an undertaking, regardless of the legal status of the undertaking, the way in which it is financed[103] and of whether the operator intends to make a profit[104]. Basing on this concept, indeed, American scholars have further argued that when a nonprofit organization engages in economic activities and compete with a for-profit firm, the principle of horizontal equity in taxation, which requires that equals be treated equally, is violated[105]: thus, they concluded, the only way to eliminate unfair competition is to make nonprofits and for-profit compete under the *same* rules (i.e., to place both types of organizations on a level playing filed).

Undoubtedly, an economic activity is involved in the tasks carried out by the social economy firms[106]; in fact, the engagement in economic activity is the factor determining the inclusion of the economy social sector in the field of enterprise policy, as remarked by the Commission since its earliest initiatives on the social economy enterprises[107].

Yet, certain featuring characteristics that are shared by a variety of legal forms stemming from the organized civil society (e.g., cooperatives, mutual societies, associations, foundations, companies, etc.) - although the social enterprise still covers a diversity of concepts that include various actors and terms at Member State level[108] - , suggest that the business activity carried out by the social economy actors stands for a *distinctive* business model, which is driven primarily by *social benefit* or *general interest* objectives (as opposed to profit objectives), with surpluses principally being reinvested to promote the objectives (rather than being distributed to private shareholders or owners).

Indeed, as the European Parliament pointed out, "*the social economy gives prominence to*

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[103] See the Höfner and Elser judgment of 1991 and the Pavlov judgment of 2000.

[104] Ambulanz Glöckner judgment of 2001

[105] James T. Bennet – Thomas J. DiLorenzo, p. 30.

[106] I.e., the question is *not* whether an activity of general interest conducted by nonprofit actors is economic or non-economic.

[107] Commission of the European Communities, Businesses in the "Economie Sociale" sector.

[108] EESC Opinion on Social entrepreneurship and social enterprise. On the different meanings of the social economy concept, *see* also the Opinion of the Economic and Social Committee on The Social Economy and the Single Market, of 2 March 2000: "In order to overcome the problem of definition, the social economy is often described as being composed of "four families": cooperatives, mutual societies, associations and foundations, which in fact are organizational and/or legal forms. […] However, not all organizations that are included within the four families wish to be considered part of the "social economy". At the same time, other players identify themselves with the social economy but do not meet the specific legal requirements of those four families that differ from one Member State to the other".

a business model that cannot be characterized either by its size or by its areas of activity, but by its respect for common values, namely, the primacy of democracy, social stakeholder participation, and individual and social objectives over gain; the defense and implementation of the principles of solidarity and responsibility; the conjunction of the interests of its user members with the general interest; democratic control by its members; voluntary and open membership; management autonomy and independence in relation to public authorities; and the allocation of the bulk of surpluses in pursuit of the aims of sustainable development and of service to its members in accordance with the general interest"[109].

These statements have *not* a merely theoretical relevance. On the contrary, they imply that the specific features of the social economy enterprise (above all, its social objectives aimed at meeting needs of general interest)[110] should be properly taken into account in the framing of legislation and public policies[111]. In fact, according to a diversified and proportionate approach, the EU Parliament stressed that *"the social economy enterprises should not be subject to the same application of the competition rules as other undertakings and that they need a secure legal framework, based on recognition of their specific values, in order to be able to operate on a level playing field with such other undertakings*"[112]. Consequently, the Parliament recommended that, beyond the development of European statutes for the different legal forms of social economy[113], measures to be implemented by the European Union and the Member States should

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[109] European Parliament Resolution of 19 February 2009 on Social Economy. On the main features that distinguish the social economy firms from the classic for-profit enterprise and the public sector, *see* also the EESC Opinion on Social entrepreneurship and social enterprise; the Opinion of the Economic and Social Committee on The Social Economy and the Single Market.

[110] In this respect, *see* Commission of the European Communities, Businesses in the "Economie Sociale" sector, stating that such enterprises belong to the economie sociale sector "because of their purposes and the way they organize and manage their productive activity".

[111] Including, beyond competition, finance, public procurement, etc. *See*, on this approach, EESC Opinion on The Social Economy and the Single Market, stating that "Due to its special features, the social economy sector needs tailor-made solutions as far as taxation, public procurement and competition rules are concerned". *See* also the EESC Opinion on the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: mid-term review of the social policy agenda, COM(2003) 312 final, of 10 December 2003, noting that "the role of the social economy as a development factor and that of the non-profit players that support it must […] be better recognised and developed in the social services and care sectors, with particular reference to European competition law".

[112] European Parliament Resolution of 19 February 2009 on Social Economy.

[113] E.g., the statute for a EU foundation, a EU associations and a EU mutual society.

include easy access to credit, tax relief as well as tailored EU funding and incentives "*to provide better support to social economy organizations operating within market and non-market sectors, which are created for the purpose of social utility*"[114].

6. The "Almunia" Package for services of general economic interest

Ultimately, the need to achieve a level playing field between firms of the social economy and other forms of enterprises by taking into account not only *economic* criteria (i.e., the economic nature of the activity) but also the *social* aspects featuring certain enterprises[115], has further influenced the controversial developments on the application of EU rules on State aid, internal market and public procurement to the so-called "social services" (i.e., health and social services)[116].

Indeed, the EU legal framework for social services is based upon a fundamental distinction:

- services of general interest of a *non*-economic nature are *not* subject to the rules covering the internal market, competition or State aid; instead,
- pursuant to article 106(2) TFEU (ex article 86(2) TEC), *"undertakings entrusted with the operation of services of general* economic *interest* […] *shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union*". Thus, services of general economic interest *can* be exempt from the competition rules under certain circumstances

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[114] European Parliament Resolution of 19 February 2009 on Social Economy.

[115] EESC Opinion on Social entrepreneurship and social enterprise.

[116] According to the Communication of the Commission on "Implementing the Community Lisbon programme: Social services of general interest in the European Union", COM(2006) 177 of 26 April 2006, the "social services of general interest" (SSGI) identify three broad types of services, namely: 1. health services; 2. statutory and complementary social security schemes covering the main risks of life; and 3. other essential services provided directly to the person (e.g., social assistance services, employment and training services, childcare, long-term care for the elderly and for people with disabilities, social housing). *See*, more recently, Commission Staff Working Document, 3rd Bennal Report on Social Services of General Interest, SWD(2013) 40 final, of 20 February 2013.

(i.e. when such restrictions are necessary to enable the enterprise to perform its *tasks* in economically acceptable conditions).

Until very recent times, although it was widely recognized that "*almost any service of general interest, even a service provided on a not-for-profit or charitable basis, entails some economic value*"[117], the sphere of the market activities run by private nonprofit providers of services of general interest[118] was deemed to be "*unquestionably, a fairly large grey area*"[119]. In fact, in view of the competitive situation with commercial for-profit firms operating in the same areas (e.g., health care), in many EU Member States the governments expressed concern about the exemptions granted for social services from the competition law rules, while the social services providers sought visible legal certainty[120].

The European Economic and Social Committee, since its earliest initiatives on the role of private nonprofit organizations in the context of the services of general interest, considered that "*social services need to be treated differently from the vast number of actors responsible for services of general interest*"[121]. More precisely, the Committee stressed that "*when social services - especially associations, foundations and charitable organizations - undertake market activities, they do not wish to restrict their role to providing segmented market services as is the case for profit-making companies (which nevertheless provide a valuable and efficient service). Instead, they also contribute to the social fabric"*[122]. Thus, it concluded that "*if their potential contribution and spheres of*

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[117] EESC Opinion on The future of services of general interest, of 6 July 2006.

[118] I. e., private not-for-profit organisations, having different status in different countries (associations or foundations), that are active in the health and social spheres, though where necessary conducting economic activities that are subordinate to their primary social functions.

[119] EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe.

[120] *See* EESC Opinion on The future of services of general interest: "there are ambiguities and contradictions between competition and SGI, the economic or non-economic nature of which remains subject to the legal interpretations and re-interpretations of the Court of Justice of the European Communities".

[121] EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe.

[122] EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe. In particular, according to the EESC, the "social services" (i.e., "a category of private not-for-profit organisations, having different status in different countries (associations or foundations), that are active in the health and social spheres, though where necessary conducting economic activities that are subordinate to their primary social functions") contribute to the general interest on three major fronts in that they: a)

activity are to be respected, care must be taken not to take them for granted and to indiscriminately subject them to the same treatment as profit-making companies with which they work side by side and encounter in some areas".

Following the Altmark judgment[123], in 2011 such developments led to the adoption of the "Almunia Package" for services of general interest[124], which defined the conditions under which financing services of general interest (e.g., grants and other forms of financing)[125] is compatible with the internal market and does *not* need to be notified to the Commission.

The fundamental premise of the comprehensive measures adopted by the Commission is that, pursuant to article 107 of the Treaty, the State aid rules generally apply *only* where the recipient is an "*undertaking*". In this respect, according to the concept of *undertaking* developed by the Court of Justice case-law and entirely based on the nature of the activity[126] - i.e., *any* activity consisting in offering goods and services on a market is an

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reflect constantly changing social requirements and seek to protect those who are most vulnerable; b) create or recreate the social fabric; and c) mobilise a feeling of solidarity among citizens.

[123] Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH. The Court of Justice ruled that financing an SGEI is *not* State aid if it is meant to fund a well-identified task (the first criterion), if the financing conditions have been defined in a clear and transparent way, ensuring that it does not exceed the costs of the SGEI (the second and third criteria), and if the service is provided in a cost-efficient manner (the fourth criterion). If these criteria are not met, the financing of a social service (e.g., a grant given by a local authority to an NGO providing long-term care to the elderly) constitutes State aid. Such State aid could be illegal and the NGO that received the grant would have to repay it to the public authority.

[124] The Almunia package is the updated version of a first package (so-called Monti-Kroes or Altmark package) adopted by the Commission in 2005 in the aftermath of the "Altmark" judgment. For the contents of the comprehensive Alumnia package for services of general economic interest, *see* Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest; Commission Decision of 20 December on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest; European Union framework for State aid in the form of public service compensation (2011); Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest.

[125] I.e. public service compensation.

[126] As described in the text above, the Court of Justice has consistently defined undertakings as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed: *see* Joined Cases C-180/98 to C-184/98 Pavlov and Others [2000] ECR I-6451. According to the Court of Justice approach, public educational institutions offering educational services are to be regarded as *economic* if they operate on a market where competing private organizations exist; similar conclusions apply to public hospitals providing health services on a market where other health care providers offers their services for remuneration: *see*, for an overview of the Court of Justice case-law, Communication from

economic activity[127] -, State aid rules apply to the financing of social services of an economic nature *even if* the service provider has a *nonprofit* status: that is, just because the service provider is a non-profit organization, this does *not* mean that the financing of the service by a public authority falls outside State aid rules.

At the same time, in accordance with the diversified and proportionate approach followed in the reform of State aid rules[128], the Commission drew attention on the specific features of services of general economic interest, compared to other economic activities[129]: as the Commission observed, "*undertakings entrusted with the operation of services of general economic interest are undertakings entrusted with 'a particular task'* "[130] (article 106(2) TFEU), and are in the interest of society as a whole.

Consequently, the *social* aims came to be given a crucial impact on the regulatory framework, by influencing the conditions under which the financing of a service of general interest by a public authority that constitutes State aid is *compatible* with the internal market and does *not* need to be notified to the Commission. Indeed, the Commission Decision of 20 December 2011 extended the exemption from the requirement of prior notification laid down in the article 108(3) TFEU (that already existed with regard to hospitals and social housing) to *all* services "*meeting social needs as regards health and long term care, childcare, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups'*[131].

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the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest.

[127] Case 118/85 Commission v Italy [1987] ECR 2599, paragraph 7; Case C-35/96 Commission v Italy [1998] ECR I-3851, paragraph 36; Joined Cases C-180/98 to C-184/98 Pavlov and Others, paragraph 75.

[128] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Reform of the EU State Aid Rules on Services of General Economic Interest, COM (2011) 146 final of 23 March 2011.

[129] Cases C-179/90 Merci convenzionali porto di Genova [1991] ECR I-5889, paragraph 27; Case C-242/95 GT-Link A/S [1997] ECR I-4449, paragraph 53; and Case C-266/96, Corsica Ferries France SA [1998] ECR I-3949, paragraph 45.

[130] *See*, in particular, Case C-127/73 BRT v SABAM [1974] ECR-313.

[131] Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest. As reported in the text above, under the 2005 Decision, the only services exempted from prior notification, regardless of the level of financing, were social housing and hospitals. This threshold was complemented by a threshold of € 100 million for the service provider's average annual turnover before tax. Public financing which exceeded € 30 million per year, or which was granted to a provider having a turnover higher than € 100 million, had to be notified to the Commission. Such a large amount was considered likely

This Decision applies to State aid in the form of public service compensation granted to undertakings entrusted with the operation of services of general economic interest (article 106(2)TFEU).

As such, it is certainly relevant to all social enterprises providing a service of general economic interest[132]. Besides, the *flexible* rationale of the Decision, which adjusts the competition rules to the specific characteristics of undertakings meeting social needs, requires that features, aims and values of the social economy players be taken into account in the application of competition rules: indeed, only applying *specific* solutions based on their *specific* characteristics makes it possible to achieve a level playing field between firms of the social economy and other forms of enterprises.

7. The role of social business according to the subsidiarity model of governance: first conclusions

The analysis above shows that two different interests, potentially conflicting with each other, are at stake in the aim to reconcile respect for competition rules with the need to consider the special characteristics of economic activities run by the social economy firms (i.e. activities which are not limited to provide market goods or services, but that *also* contribute to the "social fabric")[133], namely:

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to affect trade and competition to such an extent that a specific analysis by the Commission services was deemed to be necessary. Under the 2011 Decision, thus, for the remaining services, the notification threshold of the Decision has been lowered from € 30 million to € 15 million of annual compensation per service and the threshold for the turnover of the service provider has been eliminated.

[132] *See*, in this regard, the Commission Communication on Social Business Initiative of 25 October 2011, stating that "such a simplification [i.e., the proposals for reform of the rules concerning State aid to social and local services, thereafter implemented by the Almunia Package], could also benefit social enterprises, when they provide social services or services that do not have an effect on trade between Member States".

[133] *See*, in particular, the EESC Opinion on The future of services of general interest, of 6 July 2006: "achieving a healthy balance between the single European market on the one hand, with its requirements for freedom of movement, free competition, efficiency, competitiveness and economic dynamism, and on the other the need to take account of public interest objectives, has proven to be a long and complex process. Efforts to this end have met with a large measure of success, but some problems remain and they need to be remedied". More recently, the EESC Opinion on 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, stated: "incentive policies must not distort the principles of

- on the one side, the *general interests* lying behind the principle of an open market economy based on a free competition, which must be protected against unjustified distortions (articles 119-120 TFEU). Such interests, indeed, affect directly the EU rules governing competition and the internal market which consider State aid to be an *advantage* selectively granted to one or more undertaking by the national authorities and, as such, forbidden by the Treaty if it meets certain criteria (articles 107 and 108 TFEU)[134];

- on the other side, the *general interests* pursued by foundations and the various social economy players in the different areas where they operate[135] with the aim of meeting public needs, creating jobs, building social cohesion inclusion and active citizenship, promoting participation of civil society, enhancing health, responding to needs in education and training, creating conditions for sustainable development, contributing to the social integration of vulnerable groups, etc.[136]. Increasingly indeed since the Amsterdam Treaty, the EU and its members have also chosen to achieve such objectives in an effort to create a "*European social model*" (articles 9, 15, 151, 174 TFEU; articles 34-36 of the Charter of Fundamental Rights of EU).

From this article's perspective, such complex issue[137] should be defined according to the

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competition, but must recognize the specific features of social enterprises – which may not be twisted in order to gain undue advantage from them".

[134] As described in the above text, State aid is only considered as such if it meets all the following criteria:
- it entails a transfer of public resources by national, regional or local authorities, either directly or indirectly through a public or private body, of whatever form (aids, subsidies, loan guarantees, inputs of capital, other contributions, etc.);
- it does not fall within the scope of general measures, but remains selective and is discriminatory with regard to other undertakings or bodies;
- provides the recipient (private undertaking or public body, non-profit or otherwise) with an economic advantage that it would not have received in the normal scope of its economic activities;
- it has a potential effect on competition and trade between Member States

[135] As stated by the EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe, often they operate in difficult or costly areas that are of little interest to private profit-driven operators.

[136] On the contribution of private nonprofit organizations to the general interest, *see*, in particular, the EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe, of 12 September 2001 stressing that "when social services - especially associations, foundations and charitable organizations - undertake market activities, they do not wish to restrict their role to providing segmented market services as is the case for profit-making companies (which nevertheless provide a valuable and efficient service). Instead, they also contribute to the social fabric"; EESC Opinion on Social entrepreneurship and social enterprise.

[137] *See*, in particular, the considerations of the EESC Opinion on Private not-for-profit social services in the context of services of general interest: "the EU must respect its founding principles, in particular those on

subsidiarity model of governance, which requires "*to provide the widest possible scope for 'organized civil society' to assume its role and responsibilities*"[138].

Since earliest historical developments, indeed, the subsidiarity principle has been based upon a fundamental premise: *"it is an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and subordinate organizations can do*"[139]. Consequently, this principle has been given two concrete implications:

- a *negative* implication, which requires that the State refrain from anything that would *de facto* restrict the space of the smaller essential cells of civil society, whose initiative, freedom, and responsibility must not be supplanted[140]; and
- a *positive* implication, which requires societies of a superior order to adopt attitudes of help (*subsidium*) - i.e., of support, promotion, development - with respect to lower-order societies, so that intermediate social entities can properly perform the functions that fall to them[141].

The subsidiarity principle can be deemed inherent in the U.S. legal pattern for nonprofit organizations, stemming from the partnership between private philanthropy and the state that was established by the 1601 Statute of Charitable Uses, in which "*the state filled in gaps left by charity rather than charity filling in gaps left by the state*"[142].

Coherently, since the first federal income tax law of 1913[143] (and even a precursor statute, the Tariff Act of 1864[144]) has exempted the income of charitable organizations from federal taxation and the subsequent War Revenue Act of 1917 has allowed

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competition. There is no question of neglecting, bypassing or amending them. The aim is to interpret, manage and apply them as well as possible and, with this in mind, to develop their implementation procedures. It would be unfortunate on such an issue to bring the Community provisions on competition law into conflict with the concern to ensure suitable, specific and relevant treatment for services of general interest".

[138] EESC Opinion on Private not-for-profit social services in the context of services of general interest in Europe, of 12 September 2001.

[139] Pius XI, Quadragesimo Anno, Encyclical, 1931.

[140] Pontifical Council for Justice and Peace (2004). Compendium of the Social Doctrine of the Church, 2004.

[141] Pontifical Council for Justice and Peace.

[142] Charitable Trusts Comm. (1952). Report of the Committee on the Law and Practice relating to Charitable Trusts. London: H.M. Stationery Off., 1952.

[143] Revenue Act of 1913, Pub. L. No. 63-16, 38 Stat. 114 (1913).

[144] 28 Stat. 509, later held unconstitutional by the U.S. Supreme Court in Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895).

charitable contribution deductions[145], a tax regime *conducive* to nonprofit organizations and their contributions to society has been defended as a natural corollary of such sharing between government and civil society organizations which can be viewed as a necessary ingredient of the "*American way*"[146]. Since then, in fact, provisions for tax exemption and tax deductions have been in every federal income tax law down to Section 501(c)(3) of the IRC, which lists the charitable organizations that are exempt from federal income tax and eligible to receive tax deductible contributions[147].

The subsidiarity model also constitutes the main foundation of the European governance[148].

Indeed, the *vertical* subsidiary, invoked in the context of allocation and exercise of competences between the different levels of the Member States and the Community (i.e., it addresses the choice between action at EC or Member State level), is laid down by article 5 TEU (ex Article 5 TEC), which states:

"*the use of Union competences is governed by the principles of subsidiarity and proportionality. […] Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties* "[149].

The *horizontal* subsidiarity, which rather applies the concept of subsidiarity to the context of allocation and exercise of competences on the *same* level and therefore is a concept used to address the fundamental role of the social partners in the implementation of the social dimension of the EU (i.e., it addresses the division of responsibilities between the

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[145] War Revenue Act, Ch. 63, § 1201(2), 40 Stat. 300, 330 (1917).
[146] *See* E.K. Taylor, p. 78.
[147] I.R.C. §170.
[148] *See*, in particular, the EEESC Opinion on the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: mid-term review of the social policy agenda, COM(2003) 312 final, of 10 December 2003.
[149] *See* also the Protocol no. 2 on the application of the principles of subsidiarity and proportionality.

social partners and the authorities)[150], is outlined by several provisions, in particular:

- Declaration 23 appended to the Maastricht Treaty, which establishes: the EU "*stresses the importance, in pursuing the* [social policy] *objectives of Article 117 on the Treaty establishing the European Community, of cooperation between the latter and charitable associations and foundations as institutions responsible for social welfare establishments and services*";
- Declaration 38 attached to the Treaty of Amsterdam, which recognizes "*the important contribution made by voluntary service activities to developing social solidarity*, and affirms the need to "*encourage the European dimension of voluntary organizations*";
- Article 14 TFEU (ex Article 16 TEC), which recognizes place occupied by social services providers "*in the shared values of the Union*"[151], as well as "*their role in promoting social and territorial cohesion*", and entrusts the Union and the Member States (within their respective powers) with the task of ensuring that such

[150] Horizontal subsidiarity addresses the specific question of choices at the same level: whether the allocation and exercise of competences by the EU institutions or by the European social partners is preferable; and similarly at Member State level: whether action by the state or the social partners at national level is preferable. In its first Communication concerning the application of the Agreement on Social Policy (COM (93) 600 final, of 14 December 1993, the Commission acknowledged: "a dual form of subsidiarity in the social field: on the one hand, subsidiarity regarding regulation at national and Community level; on the other, subsidiarity as regards the choice, at Community level, between the legislative approach and the agreement-based approach". *See* also EESC Opinion on the communication concerning the application of the Agreement on Social Policy presented by the Commission to the Council and to the European Parliament, 94/ C 397/ 17, stating: "In the Maastricht Treaty the principle of subsidiarity is introduced. The European Parliament has distinguished two separate meanings of this principle: vertical and horizontal subsidiarity. With *vertical subsidiarity the EP refers to the division of competences between different levels of authorities: European, national or regional level*. *Horizontal subsidiarity refers to the division of responsibilities between the social partners and the authorities*. The criteria as mentioned in Article 3 B of the Treaty of Maastricht refer only to the vertical subsidiarity and not to the horizontal subsidiarity. Vertical and horizontal subsidiary need to be distinguished. […]. Recognition of the principle of horizontal subsidiarity in the implementation of Community law at Member State level has attained recognition in both the case law of the European Court and following the Community Charter, in the legislative practice of the Commission and Council".

[151] *See* article 1 of the Protocol (no. 26) on Services of General Interest, stating:
"The shared values of the Union in respect of services of general economic interest within the meaning of Article 14 of the Treaty on the Functioning of the European Union include in particular:
— the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organizing services of general economic interest as closely as possible to the needs of the users;
— the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations;
— a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights".

services "*operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfill their missions*".

- Article 15 TFEU (ex Article 255 TEC), which ensures the "*participation of civil society*";
- Articles 152, 154-155 TFEU, in the area of social policy, allow for EU level action not only by EU institutions, but also by the European social partners by recognizing "*the role of the social partners*" and "*promoting the consultation of management and labour at Union level*".

At national level, as of 2001, Article 118, paragraph 4 of the Italian Constitution[152] states: «*State, Regions, metropolitan Cities, Provincies and Town councils favor autonomous initiatives by citizens (single citizens or groups of individuals) to carry out common interest activities, on the basis of the subsidiarity principle*»[153].

Consistently with its historical connotations, the subsidiarity model provides the essential criteria to define the critical issue that has been challenging the business activities carried out by nonprofit organizations over the last decades:

- on the one side, indeed, such model enlightens a *subsidiary* relationship between the State (or public authorities) and the civil society organizations, by which the latter are assigned a *primary* role in pursuing the *general* interest objectives[154];

- on the other, the subsidiarity model calls governments and local authorities for *supporting* the civil society actors in the promotion of common good[155], up to an extent that must prove to be:

1. *justified*, in view of the objectives of *general interest* that distinguish the social economy actors from other forms of enterprise, and of the consequent task of public authorities to ensure that the former operate on the basis of principles and conditions

[152] Article amended by the Constitutional Law of Oct. 18, 2001, No. 3.

[153] *See* A. MALTONI, The Principle of Subsidiarity in Italy: Its Meaning As A "Horizontal" Principle, in The International Journal of Not-for-Profit Law Volume 4, Issue 4, July 2002.

[154] According to the Court of Justice case-law, the activities that intrinsically form part of the State or public authorities prerogatives and are performed by the State (unless a given Member State has decided to introduce market mechanisms), encompass, for example, activities related to the army or the police, air navigation safety and control, maritime traffic control and safety, anti-pollution surveillance and the organization, financing and enforcement of prison sentences. *See*, in particular, Case C-364/92 SAT/Eurocontrol [1994] ECR I-43, paragraph 30.

[155] As remarked by EESC Opinion on Social entrepreneurship and social enterprise, "by supporting and promoting social enterprise, we can make the most of its growth potential and capacity to create social value".

which enable them to fulfill their missions;

2. *proportionate*, meaning that the financial support from the State should *not* exceed what is necessary to enable the social economy players to perform their *general interest* activities in economically acceptable conditions, under the non-distribution constraint and reinvestment of profits rules[156].

These boundaries exclude that the financial support from the State (e.g., tax benefits, subsidies, loan guarantees, other contributions etc.) can be considered as an economic *advantage* favoring the recipient undertaking over competing undertakings (i.e., a selective measure)[157]. Rather, where these requirements (reasonableness and proportionality) are not met, the State support remains *selective* (as it will have the effect of *unjustifiably* putting the recipient enterprises in a more favorable competitive position over the enterprises competing with them), and, as such, it constitutes a measure incompatible with the protection of the general interests lying behind the internal market and competition rules.

Within the EU legal framework governing the services of general economic interest, the principle laid down by articles 14 and 106(2) TFEU, and the Court of Justice "Altmark" case[158], significantly support these conclusions. Indeed, as stated above, Article 14 TFEU

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[156] Consistently with the principle of proportionality, in fact, the Commission Decision on the application of article 106 (2) TFEU has stated that "in order to avoid unjustified distortions of competition, the compensation should not exceed what is necessary to cover the net costs incurred by the undertaking in operating the service, including a reasonable profit": Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest.

[157] As outlined in the above text, the EU rules governing competition and the internal market consider State aid to be an advantage (of any form whatsoever), selectively granted to one or more undertaking by the national authorities. In particular, State aid is considered as such and forbidden by articles 107 and 108 TFEU if it meets all the following criteria:

- it entails a transfer of public resources by national, regional or local authorities, either directly or indirectly through a public or private body, of whatever form (aids, subsidies, loan guarantees, inputs of capital, other contributions, etc.);
- it does not fall within the scope of general measures, but remains selective and is discriminatory with regard to other undertakings;
- it provides the recipient (private undertaking or public body, non-profit or otherwise) with an economic advantage that it would not have received in the normal scope of its economic activities;
- it has a potential effect on competition and trade between Member States.

[158] According to the flexible approach followed by the EU Court of Justice, indeed, provided that the conditions under which a State measure must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations are met, it follows that "those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them, such a

(ex Article 16 TEC), has entrusted the Union and the Member States (within their respective powers) with the task of ensuring that such services *"operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfill their missions*", without prejudice to the competition and State aid rules. Yet, under Article 106(2) TFEU, undertakings entrusted with the operation of services of general economic are subject to the rules on competition *"in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them"*.

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The paper' conclusions rise three crucial questions, which will be further developed in the next phase of this research:

1. above all, which criteria qualify an economic activity, as those run by social economy enterprises (e.g., foundations, associations, cooperatives, etc.), as an activity of *general interest*, which is an evolving notion depending on multiple factors (e.g., the needs of citizens, political and social factors, market developments, etc.)? Indeed, in an aim to ensure a *reasonable* and *proportionate* balance between the general interests lying behind the competition rules and those pursued by the social economy enterprises (that is, in an aim to avoid that the specific features of social enterprises may be twisted in order to gain undue advantage from them, thus realizing unjustified distortions of competition), it is crucial "*to establish clear rules to identify which entities can legally operate as social economy enterprises and to introduce effective legal barriers to entry so that only social economy organizations are able to benefit from financing destined for social economy enterprises or from public policies designed to encourage social economy enterprises*"[159].

Furthermore,

2. along with the need to shape a regulatory environment *conducive* to social economy enterprises in view of the *general interest* objectives inherent in such business model, arises the need to address the risk of abuse: that is, the need for rules intended to ensure effective monitoring of the fulfillment of the conditions that require competition rules be

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measure is not caught by Article (107(1) of the Treaty)". *See* Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH.

[159] European Parliament Resolution of 19 February 2009 on Social Economy.

waived. In an effort to increase public trust in social enterprise, recent initiatives developed at EU level focus on the development of a common EU system for measuring social outcomes, on initiatives to create a more transparent reporting system based on a standard EU method in order to increase investor confidence (e.g., countering the risk of social enterprises quickly becoming more profit-making, with excessive salaries for executives and board members), and eventually on the launch of a common EU code of conduct[160]. Finally,

3. which body should be entrusted with the monitoring function? In this respect, the US experience provides for helpful guidance. Indeed, the monitoring and enforcement of charities and philanthropic foundations in the United States was historically conceived as a state responsibility[161], while federal jurisdiction was designed primarily to raise revenue (*not* to regulate). The recent developments rather show that, beyond performing the *support* function aimed at encouraging the nonprofits' contributions to the public good (through tax relief), the tax law also came to *regulate* the nonprofit sector (e.g., IRC's prohibitions against self-dealing and jeopardy investments, etc.)[162].

However several voices across EU and US patterns consider reliance on the tax law improper, from our perspective, two key factors driving this evolution should be taken into account in an aim to address the question.

First, in the US pattern, charity oversight by the attorneys general has been faced with financial issues in all but a few states, whereas economic incentives (i.e., revenue concerns) invested the IRS with the most strategic position to oversee the sector. Similarly, budget issues have challenged the activities of the Italian Agency for the Third Sector and eventually forced the government to close it, whereas the Revenue Agency's focus on nonprofit organizations has been increasing along with the recent growth of the sector. At present, thus, the financial incentives to gain public trust in the integrity of the nonprofit sector through effective monitoring and enforcement turn out to be unique to tax authorities.

Besides empirical evaluations, the legislative history of the U.S. pattern indicates that the whole matter of nonprofits regulation is incidental to *tax*. In this respect, the reliance on

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[160] *See* EESC Opinion on Social entrepreneurship and social enterprise.
[161] C. Zollmann, American Law of Charities. Milwaukee, Wis.,The Bruce publishing company, 1924.
[162] *See* M.R. Fremont-Smith, 2004.

tax law as a vehicle for monitoring the nonprofit sector not only benefits from economic advantages that are currently unavailable to the alternative options, but also is consistent with the relationship between tax benefits and nonprofits' responsibility to the public, which constitutes the essential rationale for regulating the sector. Indeed, in the absence of the fiscal advantages linked with the social-benefit value of the nonprofits' activities, the *private* identity of the social business actors would entail moving entirely the accountability issue from state regulation toward *self-regulation*.