

If not for profit,
for what and how?

S O C I A L
E N T E R P R I S E

Current problems on the Spanish taxation of social co-operatives: A European perspective

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EMES-SOCENT Conference Selected Papers, no. LG13-64

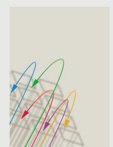
4th EMES International Research Conference on Social Enterprise - Liege, 2013

Interuniversity Attraction Pole (IAP)
on Social Enterprise (SOCENT) 2012-2017

and



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1. INTRODUCTION

As economic and legal literature uses to point out, social cooperatives are usually able to meet social goals that are at the core of the welfare state, and, in Spain, are even avouched by the Spanish Constitution. These provisions are, on the other hand, in harmony with the contents of the Social business Initiative of the European Commission. So, taxation being a tool of public interest objectives, the tax treatment of social cooperatives should be designed to make them as efficient in this aims as possible. However, after the analysis of this treatment, we doubt it, so the main question of this research would be: is the current Spanish tax law on social cooperatives being an impulse or a drawback for them to accomplish their general interest goals?

That would be divided in these sub-questions:

- Which are the main problems that the tax treatment poses on Spanish social cooperatives?
- Are there some clauses in the tax treatment of Spanish social cooperatives that are incompatible with the goals included in the Social Business initiative?

So we should be able to know if the tax system in Spain is accomplishing the aim of encourage the creation and work of this kind of Social business, such as the Social Business Initiative suggest the Member States to do.

2. LEGAL TAX FRAMEWORK FOR SOCIAL CO-OPERATIVES IN SPAIN

2.1. Overview of the legal framework for social co-operatives.

In recent years, the existence of cooperatives performing not only labor integration, but also engaged in social needs, sometimes through the provision of social services, has been collected in Spanish national and regional legislation. Although not creating a special kind of cooperatives, such in Italy the social cooperatives, but within an existing category, usually worker cooperatives or consumption and services.

The Explanatory Memorandum to the State Law of Cooperatives, 27/1999, refers to:

"The new social demands of solidarity and new employment generating activities, are served by the Act, providing collective self-employment as a means for social integration, paying special attention to people with difficulties in finding work and public participation in this sector"

Also indicates that:

"New activities are collected within the different types of cooperatives, as social initiative cooperatives..., depending on the purpose of social integration ..."

Specifically, and in furtherance of this goal, the law provides in Article 106 the existence of a new kind of cooperatives, the **social initiative cooperatives**, which are nonprofit cooperatives by legal definition, and can be of any traditional branch (labor, consumption, etc.). These cooperatives have social purpose, by means of the provision of welfare services such as health care, education, cultural and other social nature, or the development of any economic activity taking aim at the integration of people who suffer any way of social exclusion, and in general, aiming the satisfaction of social needs not met by the market.

Social cooperatives, in State law and Regional law, are characterized:

- By their activity: they can provide social or public services, or perform labor integration by an economic activity;
- By their denomination: usually cooperatives of social initiative, social integration, of social services. Also there are cooperatives of public services, whose shares are mainly owned by a public administration.
- By their kind: usually they are workers cooperatives, or consumers/users cooperatives.

On the other hand, the cooperatives law usually set up the requirements that cooperatives have to meet in order to be qualified as non-profit.

The State law 27/1999, in connection with the provision of public and social services, generally establish and regulates, without connecting this character to any particular kind of cooperative, the qualification "non-profit". So any kind of cooperative can enjoy this qualification. Specifically, the first additional provision of this Law indicates that companies may be classified as nonprofit cooperatives, when managing services of collective interest or public ownership, as well as conducting economic activities leading to the employment of people suffering from any kind of social exclusion. Later, it enumerates the requisites for the qualification of nonprofit that the cooperative has to meet. The cooperative's Statutes had to contain the following clauses:

One. Positive results occurring in a financial year may not be distributed among its members,

Two. The interest paid to contributions of social capital partners, both mandatory and voluntary, may not accrue more than legal interest, subject to the possible updating of the same.

Three. The free nature of the performance of roles of the Governing Board, but for the compensation of the expenses that may be incurred by directors in the performance of their duties.

Four. The remuneration of employees or partners where appropriate, of the working partners and employed persons, may not exceed 150 per 100 of market value, depending on the activity and professional category, and regarding the collective agreement applicable.

Most regional laws that expressly regulate nonprofit cooperatives (Law Balears, Madrid, Murcia, Navarra and La Rioja) include the same requirements as this State law, and only a little number of them exhibit some slight differences.

2.2. Tax treatment of Spanish social cooperatives.

The Spanish tax treatment on social cooperatives is similar to the rest of kind of cooperatives, not taking the law any notice of the fact of their specific features, such of the non-profit goals, or the social services they provide. They are not subjected to the regime applied to the non-profit Entities, such as Associations or Foundations (Law 49/2002), but to the one applied to worker's cooperatives, or services cooperatives (Law 20/1990).

So sometimes these cooperatives may not meet the requisites of the tax law to get the tax benefits of cooperatives, as they are thought for another kind of cooperatives in Law 20/1990.

In the Spanish tax system, the treatment of the non-profit entities and that which applies to cooperatives is very different:

Non-profit Entities: the tax treatment has its foundation in two criteria. Firstly, their non-profit character, which make them not fit for taxation, as they have little income or not income at all. Secondly, there are incentives based on the general interest of the activities performed by these

Entities when they carry them out. These incentives are applied on the Corporation Income tax of the Non-profit Organization, and/or the donatives and gifts or allowances made to them by Enterprises, particular people, etc.

So, they can be taxed on the Spanish Corporation Income tax in one of two ways:

- 1) Partial exemption, safe the income derived of economic activities, taxed at 25% (arts. 120 and following of TR 4/2004, ruling Corporation Income Tax);
This treatment is mostly based in the nonprofit character of the Entities, such as Associations, Foundations, etc.
- 2) The most favorable regime of Law 49/2002, which provides
 - a. Whole exemption on Corporate income tax, safe some very little income on economic activities, taxed at 10%.
 - b. Eligibility for tax-incentivized donations and gifts: they can be receiver of them.

This last treatment connected to the special aims of these Entities, as much as the activities carried out by them. And, of course, it has to do also with their non-profit nature. The application of this tax treatment is reserved to some specific Entities: Foundations, Associations of public interest, and such. The co-operatives are not in the list of the benefited by this treatment. In addition, state law on cooperatives, 27/1999 established in its ninth Additional Provision, the taxation of nonprofit cooperatives (as defined in the 1st DA) in the following terms:

"The tax regime applicable to cooperative societies classified as non-profit entities will be the one established in the Law 20/1990, of December 19 of the Taxation of Cooperatives." This is, in our opinion, a provision that strongly discourages the formation of such cooperatives, and implies losing the opportunity of creating a special tax regime for these cooperatives outside the categories provided in the law 20/1990, since this did not fit the realities of the social co-operatives.

Co-operatives: the tax treatment is mostly based on the specificities of their mutuality nature, as much as the beneficial external effects they have for the public welfare. The tax treatment of cooperatives in Spain distinguishes between two types of cooperatives:

- Normal cooperatives, which are considered fiscally protected. These have a tax rate in the lowest income tax that generally 20% for transactions with its members.
- Specially Tax-Protected Cooperatives: In addition to the tax rate, they have an exemption of half the quota of the Corporation Income tax.

Law 20/1990 only considers cooperatives *especially* protected those that fit the following categories (Art. 7):

- a. Worker cooperatives.
- b. Agricultural and fishery Cooperatives.
- e. Consumer Cooperatives

In addition, to achieve the tax treatment there are some requirements outlining a model of "pure" cooperative on each category, deepening the mutual activities rate, and limits the existence of other members different from individuals.

Non profit	Partial Exemption Arts. 120 and full Corporation Income Tax law	Exemption of income derived of quotas, grants, etc. Taxation at 25% of income derived economic activities, real estate, etc.
	Exemption Law 49/2002	Exemption on income safe some economic activities taxed at 10%
		Tax incentivized donations and gifts
Cooperatives	Protected cooperatives	Tax rate on operations with members 20%, instead of 30%
	Especially protected	50% deduction of the tax to be paid

3. THE TAXATION DRAWBACKS FOR THE ACCOMPLISHMENT OF THE SOCIAL BUSINESS INITIATIVE GOALS.

On the other hand, some of the requisites, in our opinion, are contrary to the goals aimed by the Social business initiative.

3.1. Goals of the SBI

The Commission makes a specific reference to socially innovative companies in Chapter 2.4 of the 2010 Communication "Towards a Single Market Act. For a highly competitive social market economy. Fifty proposals for work, business and exchanges with one another ", which has the title of: "New Media for a social market economy ". We should emphasize at this point the proposals n° 36 and 37. The Proposal No. 36 is an initiative for social enterprises to support innovative business projects in the social development in the single market. According to the Commission, social innovation is a source of economic growth and social cohesion. So, like that "... have provided creative solutions to major socioeconomic problems caused often by a foreclosure situation (access to agro-food, housing, to health care, the labor market, to banking , for services facilitating the inclusion of people with disabilities, etc..), as well as the aging of the population. "

In Proposal No 36, the Commission announced the proposition in 2011 of an initiative for social enterprises, to support business projects innovators in social and guide development in the single market, using, in particular, the social assessment, the granting of distinctive ethical and environmental public procurement, the establishment of a new regime of investment funds, and the collection of idle savings.

In addition, specific reference is made to the need to encourage the social economy enterprises in the proposal 37 °:

"The Commission will propose measures to improve relevant legal structures in order to optimize their functioning and facilitate their development within the single market ".

Social enterprises were considered a priority (number 8) of the 12 exposed in Communication "Single Market Act. 12 levers to boost growth and strengthen confidence "Working together to create new growth" of April 13, 2011.

The European Commission explicitly considers social enterprises as a part of the social economy, and so can be seen in the Communication Review of the "Small Business Act" for Europe, which is

committed to "adopt by the end of 2011, an Initiative social Enterprise on businesses with a social purpose."

This initiative is the subject of the Communication "Building an ecosystem to promote social enterprises in the center of the economy and social innovation" of 25 October 2011 (COM (2011) 682 final) and is aligned with the contents of the Communication on corporate social responsibility of the same date (COM (2011) 681 final). With this Communication, the Commission had two objectives:

- a) Submit a plan for short-term action to reinforce the development of social enterprises, key stakeholders in the economy and social innovation.
- b) Submit to discussion the reflection lines oriented to medium or long term.

It noticed the possibility of social enterprises to benefit from the initiatives of the Small Business Act (Review of the "Small Business Act" for Europe - COM (2011) 78 final) to the problems shared with SMEs but also on the availability of specific problems, highlighted in several reports¹. These problems are mainly:

- the access to finance,
- poor recognition of social entrepreneurship,
- And the lack of *ad hoc* regulation in its regulatory environment.

Therefore, the Commission proposes 11 key actions - collecting the contents of the proposals 36 and 37 to which we referred before, in the Communication of 2010. From these actions, we must note here, for the purpose of our analysis:

- Improving their access to finance, especially risk capital,

"3.1.1 Facilitating access to private funding,

The Commission considers that the funding system for social enterprises is underdeveloped in relation to that used by other business.

Increasing numbers of investors are seeking to combine social or environmental results with their legitimate concern of obtaining a financial return on the investment, while pursuing long-term objectives in the general interest."

- Checking that their legal framework doesn't punish this kind of business (point 3.2 of the Communication).

Let's see what happens with Spanish tax treatment on Social cooperatives.

3.2. Clauses of the tax treatment which could be incompatible with these goals.

We have detected that there are some tax barriers in the Spanish legislation to the goals aimed by the Social Business initiative, and the Commission policies about social enterprises. And they are a drawback also on the sustainability of the cooperatives themselves.

Firstly, the not application of the non-profit entities tax treatment has meant:

- They have no access to the system of patronage and sponsorship fiscally stimulated, making it difficult to finance them in the private sector.

¹ Study on Practices and Policies in the Social Enterprise Sector in Europe, Austrian Institute for SME Research and TSE, Faculty of Economics, Turku, Finland-Vienna, June 2007, report commissioned by the European Commission; Empowering people, driving change: Social innovation in the European Union, Conseiliers Bureau des Politiques (BEPA), European Commission, July 2010

Which is worse, the reception of gifts or donatives from private parties are considered as "extra-cooperative" income, and it is taxed more heavily than the "cooperative one", at the normal tax rate of 30% instead of 20%, in the Corporation Income tax. The treatment is the same applied to income derived from activities out their typical one, or from operations with third parties (non- mutual operations).

- Social cooperatives will be taxed in the income tax on a regime designed to promote mutual operations, not the activities of general interest. Therefore, it will be difficult to meet the fiscal requirements planned for the rest of cooperatives, on one side. On the other hand, also, fulfilling these requirements will make difficult getting financiation (they can't get donations from third parties), and to meet its objectives (they can't work with non-members).

Secondly, there are also barriers on the requirements to be especially tax-protected cooperatives. As social co-operatives usually would be worker's co-operatives or consumers/users cooperatives. They could be included in that category of specially protected in principle, but they have to meet the particular conditions imposed on these kinds of cooperatives to achieve it fully.

Thus, in particular, are heavy to carry: for worker cooperatives and consumer cooperatives, only **individual shareholders** are allowed to develop their work in the cooperative or be member of it (art. 8) or to be member of the consumer cooperative (art. 13). This prevents the entry of companies in the capital of the cooperatives that could assume the role of venture capital.

Furthermore, **cooperative partners only can be consumer or workers**, not being allowed to have investment partners or partners playing other role about the social cooperative, as, for instance, volunteers. However, this prevents them to get funding, as much as makes difficult the "social innovation" that is characteristic of social cooperatives. As indicated RICHER², the traditional cooperative model is based on a single type of members: consumers, producers, or workers who are simultaneously cooperative enterprise owners and users of their services. The fact that the same cooperative conduct various activities, such as marketing the products of its partners, the supply and credit, do not change this feature: usually they have a single type of membership, the member-user, whose typical needs serves the cooperative enterprise.

But faced with new contexts and needs, the cooperative formula has evolved, generating innovative forms of organization, such as social services and health, by integrating users and workers as union members. Internationally, this formula with various types of cooperative members has spread significantly, particularly in day care³, in the care of children and young people. In Italian social cooperatives, for instance, there is a wider range of partners: users, workers, voluntary workers, support agencies.

Thirdly, in relation with consumer cooperatives, it must be noted that the special protected treatment is applied only to the cooperatives delivering goods (and not services) to their members (or third parties). This requirement is especially difficult to meet by **social cooperatives providing social services**, so when they are owned by their users, paradoxically, **are non-tax especially protected cooperatives**, as they don't fit the type.

Fourthly, the **social cooperatives that are worker's cooperatives** have also specific problems with the tax treatment. We will analyze some of them:

To be especially protected cooperatives, worker's cooperatives must meet some limits to hire employees who are not members. On the other hand, the income earned by the cooperative will be

² RICHER, Madeleine "Una nueva fórmula cooperativa que asocia diversos tipos de miembros: la Cooperativa social", Cayapa Revista venezolana de Economía social, año 8, n° 16, july-December 2008, 280-290.

³ Vid PESTOFF, Victor (2006), "Citizens as Co-Producers of Welfare Services: Childcare in Eight European Countries", *Public Management Review*, Vol. 8, No.4: 503-520.

taxed at 30% of tax rate in the Corporation Income Tax when derived from their workers. Adding up these two legal provisions, the effects are:

- In Social cooperatives providing social or public services, their specific characteristic of the general interest of their activity is not recognized by the law. The only factor to take into account is mutuality.
- Worse is the situation for social cooperatives performing labor integration: Labor integration enterprises can be classified, from the perspective of the temporary stay of the subject in the insertion process, in two kinds: first runner character, created to achieve the inclusion of those who, because of their special difficulties insurmountable, seek to develop their careers in these entities. They provide stable jobs to workers with reduced labor productivity⁴, usually through participation in the companies by these workers.

Secondly, we have to refer to the so-called **transition companies**, characterized by allocating a significant percentage of their jobs to insertion process persons, who complete their apprenticeships and gain the employability enough to enter the outside labor market. They are authentic training centers that perform professional training for job qualification to workers with reduced labor productivity. These companies are covered by specific Spanish state law, the law 44/2007, of December 13. The insertion company regulated in such law, therefore, is an instrument for the inclusion of the excluded sectors of society, through a temporary labor provision in an integration enterprise that allows the transition from the person in a situation of social exclusion to someone fit for regular employment. In that sense, the work activity would be part of the intervention measures, following the route of insertion that is the target of the labor integration activity. There are "normal" workers (not in the target group of labor integration) and insertion workers.

In this kind of enterprises, and because of the temporary situation on the job occupied by the person who is the target of the itinerary of labor integration, it has no sense to make him or she member of the cooperative, as this should be a permanent position. So for them is really difficult to accomplish this limit. On the other hand, the income deriving of the sale of the products or services made by the person in the process of integration, if he/she is not a member, will be taxed more heavily than the derived of the member of the cooperative in a permanent basis, usually the teaching or "normal" workers, because is considered "extra cooperative" income.

Finally, the worker's social cooperatives have another tax issue that prevents their normal way of functioning: the tax value of the work provided by members. Indeed, art. 15 of Law 20/1990 apply always market value to the "salaries" of members, as a mean to prevent the deduction of expenses on the cooperative by means of raising these salaries. The problem with social cooperatives is the opposite: what happens when the members earn less than market value for his/her work? Technically, the situation must be reversed in the Income tax and the Corporation Income tax, assigning market value to the member, who will be taxed for an income he never perceived. The situation is aggravated is we take into account that Article 15 of the proposed Directive on a common tax base for corporate income tax, by the Commission, states that "the benefits afforded to a partner who is an individual, spouse, ancestor or descendant in the first degree or associates, and which directly or indirectly in the management, control or capital of the taxpayer, as provided in Article 78, it shall be considered deductible expenses to the extent that such benefits will not be granted to an independent third party".

This provision, that could be logic in a capital owned enterprise, is not reasonable in a cooperative, in general. Less so in a social cooperative.

⁴ Vid. AA.VV. (dir.: J.L. García Delgado): Las cuentas de la Economía Social. El Tercer Sector en España, Fundación ONCE y Thomson-Cívitas, 2004, p. 200.

4. CONCLUSIONS

The European Commission in its initiative by the European Social enterprise has indicated the need to improve the legal system of social enterprises, and to facilitate their access to funding sources.

Taxation of Spanish social cooperatives could be violating these two objectives:

On one hand, it makes it difficult for social cooperatives access to venture capital funding and private sponsorship and support.

On the other, it does not meet the mode of operation of this type of social enterprises that are fiscally penalized.

The tax treatment of Spanish social cooperatives not acknowledges their character of entities that perform activities of general interest, applying the tax regime for cooperatives that is based mainly on mutual values.

That treatment penalizes income earned by private donations, which will be taxed more highly, instead of being encouraged fiscally.

The requirements for being especially tax-protected cooperative hinder their access to venture capital and the development of social innovation in the cooperative. Also penalize social service cooperatives, and cooperative performing that labor integration.