

# **DETERMINANTS OF THE SOCIAL ENTERPRISES DEVELOPMENT IN POLAND – ANALYSIS OF THE SELECTED TAX INCENTIVES TO SUPPORT THE SOCIAL ENTERPRISES DEVELOPMENT**

## **DETERMINANTY ROZVOJA SOCIÁLNYCH PODNIKOV V POLSKU - ANALÝZA VYBRANÝCH DAŇOVÝCH STIMULOV NA PODPORU ROZVOJA SOCIÁLNYCH PODNIKOV**

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### **Abstract**

The aim of the paper is to assess the key factors for the social entrepreneurship development. The paper shows the benefits of the social enterprise activity as well as the barriers to the development of this sector. The selected tax incentives to support the social enterprises development are the subject of detailed analysis.

Key words: social enterprise, determinants of development, finance, taxes

### **Abstrakt**

Cieľom príspevku je zhodnotiť kľúčové faktory pre rozvoj sociálneho podnikania. Článok ukazuje výhody činnosti sociálnych podnikov, ako aj prekážky pre rozvoj tohto odvetvia. Vybrané daňové stimuly na podporu rozvoja sociálnych podnikov sú predmetom podrobnej analýzy.

Kľúčové slová: sociálny podnik, determinanty vývoja, financie, dane

### **INTRODUCTION**

Social enterprise has developed from the need to correct market failures in the provision of socially important goods and services and from the awareness that social problems cannot be adequately solved by traditional not-for-profit and philanthropic approaches.<sup>1</sup> The financial and legal system should create incentives for the social enterprises development. The aim of the paper is to assess the key factors for the social entrepreneurship development. The paper shows the benefits of the social enterprise activity as well as the barriers to the development of this sector. The selected tax incentives to support the social enterprises development are the subject of detailed analysis.

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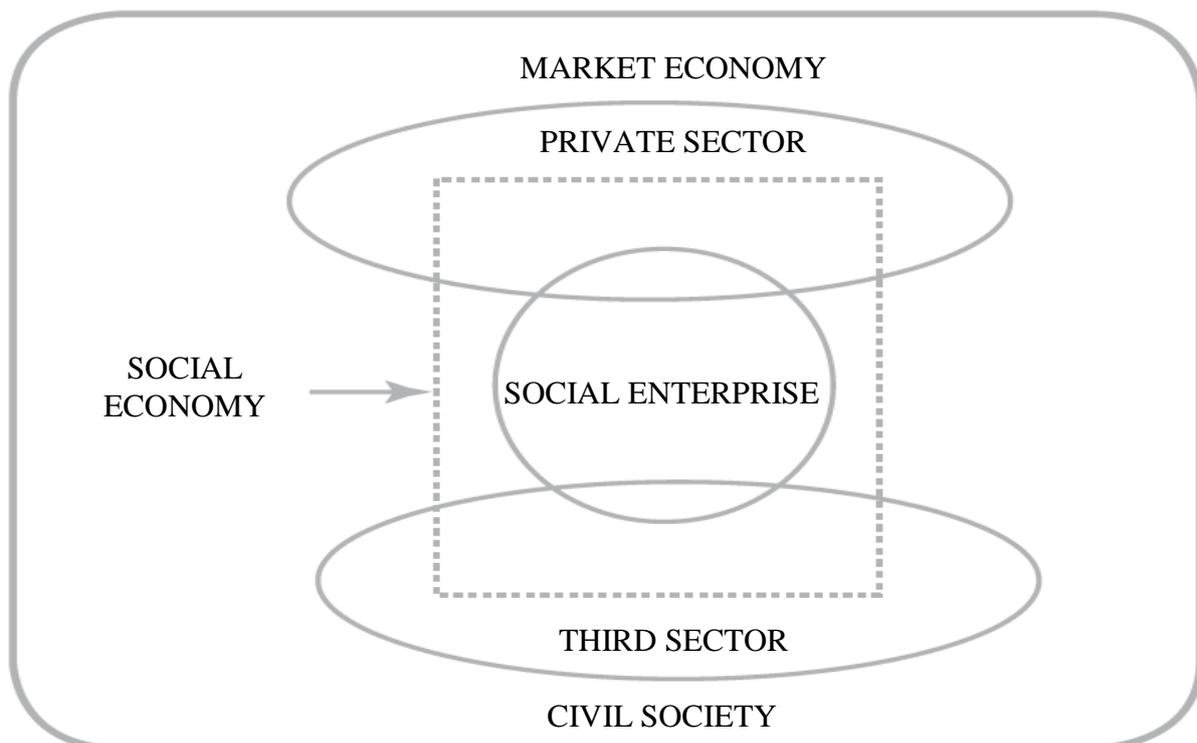
<sup>1</sup> Heaney V., Hill K., *Investing in Social Enterprise: the role of tax incentives*, Centre for the Study of Financial Innovation, May 2010, p. 4.

# 1 SOCIAL ECONOMY AND SOCIAL ENTERPRISE

The social economy combines social and economic objectives. The concept of social economy goes back to the 19th century when various new types of organisations and enterprises were formed collectively by groups of people in response to problems they were facing due to deep transformations of the economic system: co-operative societies, friendly (mutual benefit) societies, and other forms of undertakings which aimed at organizing production, consumption, access to credit, access to health care and other services on a more equitable and democratic basis.<sup>2</sup>

"The social economy is not only the result of legal resolutions and acts. It is not only a question of social awareness, though public support is very significant. The social economy is a social movement that should lead to a new vision for Poland's development. The social economy is a way of involving the third sector in Poland's economic development" – J. Hausner, former Minister of Labor and Social Policy and former Vice-Premier.

The social enterprise connects the third sector with the private sector, thus becomes one of the important institutional forms of relationship between civil society and market economy. The social enterprise is also an important segment of the social economy, which includes the various organizational forms and institutions. These relationships are shown in the figure 1.



**Graph 1. Social enterprise in the economic system**

Source: J. Hausner, N. Laurisz, *Czynniki krytyczne tworzenia przedsiębiorstw społecznych. Przedsiębiorstwo społeczne. Konceptualizacja*, [in:] J. Hausner (red.), *Przedsiębiorstwa społeczne w Polsce. Teoria i praktyka*, Uniwersytet Ekonomiczny w Krakowie, Kraków 2008, p. 10.

Many authors have formulated the definitions of a social enterprise. One of such attempts is the proposal contained in the document of the British Government, published in 2002, according to which "social enterprise is a business activity which has social objectives and

<sup>2</sup> EMES European Research Network, <http://www.emes.net/about-us/focus-areas/social-economy/> (10.10.2014).

invests profit in this activity or in the community, rather than achieves maximum profit for shareholders and owners”<sup>3</sup>. Other author, John Pearce has formulated the following definition of social enterprise: “It is a general term for all economic entities that have a social purpose, are not focused on the creation and distribution of capital and have a democratic, based on a common management structure”<sup>4</sup>.

For the social enterprises is considered the activity with social purposes, which profits are reinvested in the social projects or the community rather than maximize profits or increase income for shareholders or owners. The most popular definition of social enterprise is that formulated by the European Research Network under the project *The Emergence of Social Enterprises in Europe* (EMES). EMES determines the social and economic criteria, which should have a social economy initiatives. This package of criteria is the definition of a perfect social enterprise, therefore does not require the social enterprises meet all the criteria, but most of them.

**Table 1. The EMES criteria of social enterprise**

<b>Economic criteria</b>	<b>Social criteria</b>
1. Continuous, regular activity, based on economic instruments	1. Focus on socially useful goal of the project
2. Independence and sovereignty in relation to public institutions	2. Grassroots, civic initiative
3. Economic risk	3. Democratic management system
4. The existence (even a few in number) of paid staff	4. Community nature of the action
-	5. Limited distribution of profits

Source: Foundation for Social and Economic Initiatives, <http://www.ekonomiaspoleczna.pl> (10.10.2014)

The literature review shows that social enterprises have some common features:<sup>5</sup>

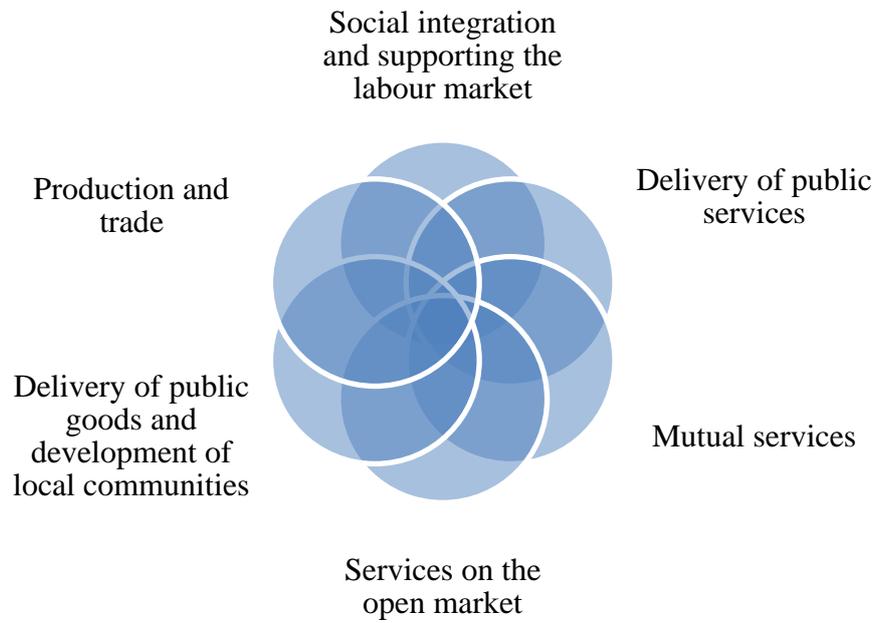
- they reflect pursuit of opportunities to catalyse social change and/or address social need and serve social mission;
- they contribute to a more efficient market competition and encourage solidarity and cohesion;
- their primary purpose is not to obtain a return on capital;
- they are run generally in accordance with the principle of solidarity and mutuality and managed by the members on the basis of the rule "one man, one vote";
- they are flexible, entrepreneurial and innovative as they meet changing social and economic circumstances;
- they are based on active membership and commitment and very frequently on voluntary participation;

<sup>3</sup> J. Defourny, *Przedsiębiorstwo społeczne w poszerzonej Europie: koncepcja i rzeczywistość*, [in:] „Ekonomia Społeczna“ II Europejska Konferencja Ekonomii Społecznej, Kraków 2004, Ministerstwo Polityki Społecznej, Warszawa 2005, p. 51.

<sup>4</sup> J. Pearce, *Social Enterprise in Anytown*, Colouste Gulbenkian Foundation, London 2003, p. 190.

<sup>5</sup> A. J., Germak, K. K. Singh, *Social entrepreneurship: changing the way social workers do business*, *Administration in Social Work*, 34(1), 2010, p. 86-89, S. Kelly, *Ekonomia społeczna i przedsiębiorczość społeczna w Unii Europejskiej*, In T. Kazimierczak, M. Rymśa (Ed.), *W stronę aktywnej polityki społecznej*, Fundacja Instytut Spraw Publicznych, Warszawa, 2002, p. 35, J. Mair, I. Martí, *Social entrepreneurship research: A source of explanation, prediction, and delight*, *Journal of World Business*, 41(1), 2006, p. 38, P. Tracey, N. Phillips, O. Jarvis, *Bridging institutional entrepreneurship and the creation of new organizational forms: a multilevel model*, *Organization Science*, 22(1), 2011, p. 66-70, OECD, *The Non-profit Sector in a Changing Economy*, Paris 2003, p. 27.

- they are the result of an initiative by citizens involving people belonging to a community or to a group that shares a certain need or aim;
  - they pursue an explicit aim to benefit the community or a specific group of people. By doing so, they directly and indirectly promote a sense of social responsibility at local level.
- Social enterprises could have very different functions. The picture below (graph 2) shows the main functions and responsibilities of social enterprises. It should be noted, that due to a still small-scale of social economy in Poland, many of the areas have been waiting to develop.



**Graph 2. Functions and responsibilities of social enterprises in Poland**

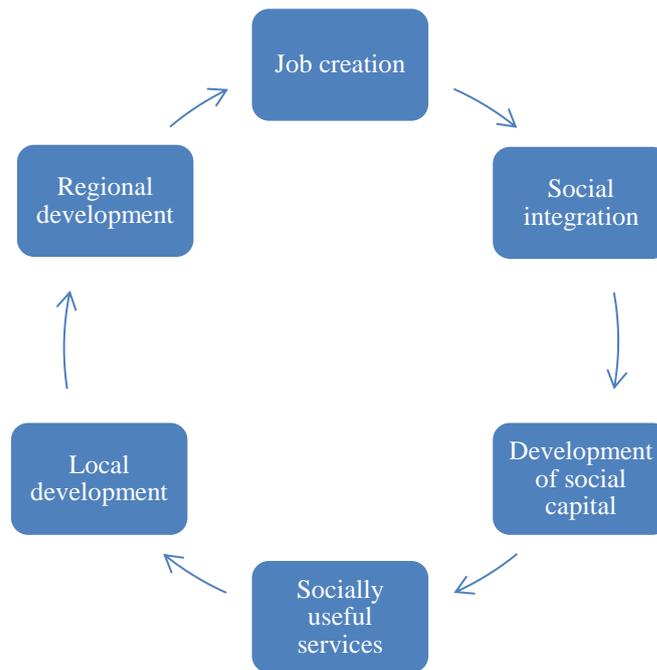
Source: Foundation for Social and Economic Initiatives, <http://www.ekonomiaspoleczna.pl> (10.10.2014)

## 2 DETERMINANTS OF SOCIAL ENTERPRISES DEVELOPMENT

The social economy should be seen as a complementary activity to the market and the state.<sup>6</sup> As J. Hausner notes: "The most important function of the social economy is to prevent social exclusion"<sup>7</sup>. The social economy can perform a number of functions relevant to the development of communities. The benefits from the development of the social economy are shown in graph 3.

<sup>6</sup> W. Kwaśnicki W., *Gospodarka społeczna z perspektywy ekonomii liberalnej*, „Trzeci Sektor”, No. 2/2005, p. 11.

<sup>7</sup> Hausner J., *Ekonomia społeczna a rozwój, skrypt 1*, MSAP UEK, Kraków 2008, p. 15.



**Graph 3. The benefits from the development of the social economy**

Source: K. Herbst, *Perspektywy ekonomii społecznej*, "Ekonomia Społeczna" 1/2013 (6), p. 17.

M. Wronka has identified the eight most common critical success factors for social enterprises. These are<sup>8</sup>:

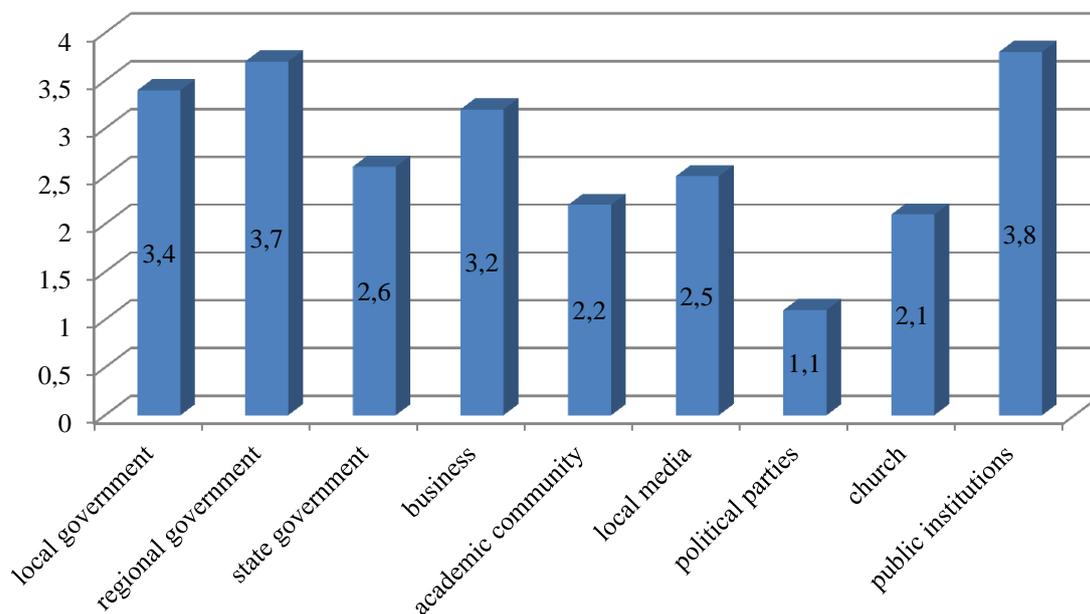
- 1) strong leader (leadership): engaged into leading and coordinating the enterprise, with the high justification and suitable qualifications;
- 2) partnerships: the ability to negotiate and maintain a core set of relationships for the benefit of the enterprise, especially with local public sector institutions;
- 3) triple bottom line planning: a bottom line that measures economic benefits, but also measures the organisation's impact on people and on the planet. The triple bottom line is a way of expressing a company's impact and sustainability on both a local and a global scale;
- 4) attractiveness and clarity of innovative concept: product proposed to the customers should be able to demonstrate, that a new idea has market potential;
- 5) business planning and marketing: either the leaders of the enterprise have business and marketing skills, or have access to those skills in their key partners;
- 6) short and long term benefits management: enterprise should demonstrate how it is going to deliver both long and short term benefits for its stakeholders to keep them engaged and committed;
- 7) local community engagement: success of the enterprise depends on the successful engagement of the local stakeholders and beneficiaries;
- 8) risk management: planning of activities in order to avoid risk and impact of extrinsic factors.

J. Housner and N. Laurisz have examined the key development factors of social enterprises in Poland.<sup>9</sup> The study focuses on the following areas:

<sup>8</sup> M. Wronka, *Analyzing the success of social enterprises – critical success factors perspective*, Active Citizenship by Knowledge Management & Innovation, International Conference 2013, Zadar, Croatia 19 – 21 June 2013, p. 599.

<sup>9</sup> J. Hausner, N. Laurisz, *Czynniki, op. cit.*, p. 19-30.

- activity area,
- aim of the activity,
- social added value,
- financial aspect,
- the ability of business,
- staff,
- management,
- management team,
- social participation,
- directions and forms of cooperation,
- environment,
- external evaluation,
- support.



**Graph 4. The assessment of the cooperation between the social enterprises and various entities on a scale of 1 to 5,**

where 1 indicates a lack of cooperation, 2 – insufficient cooperation, 3 – correct cooperation, 4 – good cooperation, 5 – very good cooperation

Source: J. Hausner, N. Laurisz, *Czynniki, op. cit.*, p. 24.

The authors noted the importance of cooperation for social enterprises with different entities operating in their environment. The data presented in the graph 4 indicate that the best cooperation exists between the social economy sector and public institutions, and further the regional and local government administration. The cooperation with the business was also highly evaluated. This confirms the trend of corporate social responsibility, consisting mainly of business financial involvement in assisting non-governmental organizations, and supporting social initiatives. The cooperation with the state government was at unsatisfactory level. In addition, respondents negatively assessed the cooperation with the political parties, church and academic community.

According to the research results the most important forms to support the social enterprises are:

- direct subsidies - 90% of respondents considered it as the most desirable form of support activities,
- preferential loans and credits - to enable social enterprises to use funds especially in a situation of loss of liquidity, e.g. during the later stages of projects or applying for new projects (75% of respondents considered this as the most desirable form).

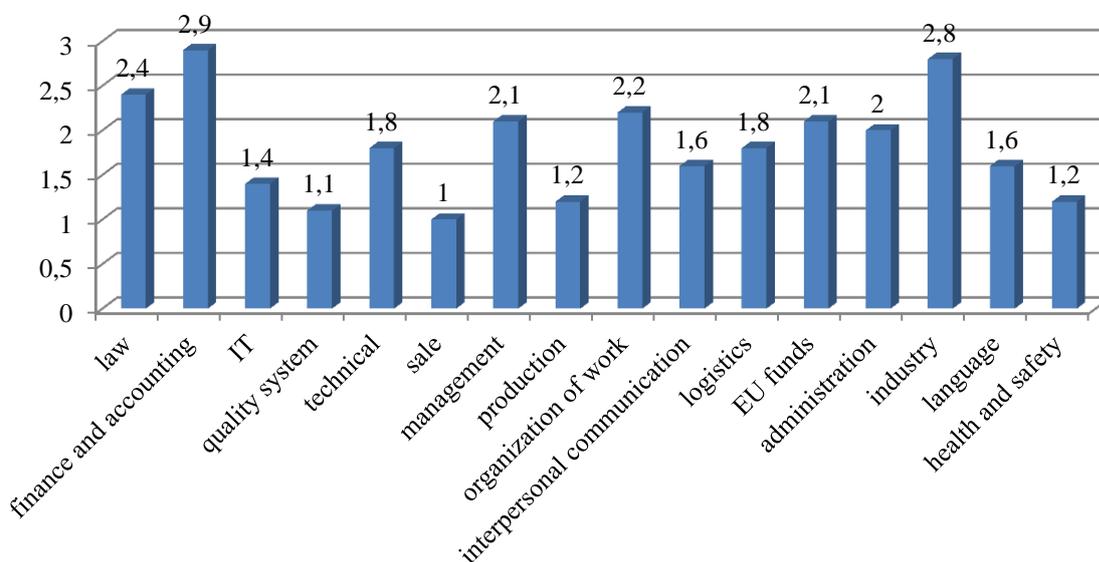
In contrast, a small part of the companies surveyed are interested in such forms of support such as:

- preference in the award of public contracts for social enterprises implementing social objectives (26%),
- access to free information and advisory services (22%),
- possibility of using guarantee funds and of credit guarantee funds (18%).

Social enterprises have many limitations, among which the most important barriers are raising capital. Funding opportunities in the social economy sector mainly depend on organizational form of the entity and the degree of economization of activity.<sup>10</sup>

According to J. Housner and N. Laurisz barriers to social enterprises include:<sup>11</sup>

- accumulation of negative social and economic features in rural and underdeveloped areas,
- lack of confidence in the initiatives undertaken by social enterprises
- low level of activity of local communities,
- perception of social enterprise as an entity operating in the areas of social exclusion, and therefore offering goods and services at a low level,
- lack of social trust for the creation of the partnership and the lack of ability to cooperate on the implementation of the common goals,
- lack of cooperation between social enterprises at the local level.



**Graph 5. The value of the upper quartile of the demand for training on a scale of 1 to 3,**  
where 1 means useful, 2 – needed, 3 – necessary.

Source: J. Hausner, N. Laurisz, *Czynniki, op. cit.*, p. 27.

<sup>10</sup> W. Pełka, *Rynkowe instrumenty finansowania działalności przedsiębiorstw społecznych w Polsce*, [in:] „*Ekonomia społeczna*“ 2/2012 (5), p. 41.

<sup>11</sup> J. Hausner, N. Laurisz, *Czynniki, op. cit.*, p. 26.

It should be emphasized that there is a kind of discrimination of social enterprises (referring to the commercial entities), including a lack of access to free or subsidized training courses in business and the lack of specialist training. The demand for training according to respondents is presented in graph 5.

### **3 SELECTED TAX INCENTIVES TO SUPPORT THE SOCIAL ENTERPRISES DEVELOPMENT**

For social economy development it is important to ensure sustainable and balanced funding for social enterprises. The tax system should also support the social economy by the tax preferences and tax exemption.

The Corporate Income Tax Act dated 15th February 1992 provides the following selected exemptions for social enterprises in Poland:<sup>12</sup>

- exemption for the preferred income allocated in preferred targets,
- exemption for preferred companies income allocated in preferred targets,
- exemption for church legal entities,
- exemption for public benefit organizations,
- exemption for income of Volunteer Fire Department,
- other similar objectively – subjective exemption,
- exemptions for enumerated social enterprises in a particular part.

#### **Exemption for the preferred income allocated in preferred targets**

According to the Corporate Income Tax Act so-called “preferred income” (income other than from the manufacture or trade in the electronics industry, fuel, tobacco, spirits, wine, beer, and other alcoholic products with an alcohol above 1.5% as well as products made of precious metals) is exempt from income tax if this income is achieved by the so-called “preferred entities” (CIT taxpayers with the exception of commercial companies, cooperatives and state-owned enterprises, which statutory purpose are so-called “preferred general objectives” including: scientific, scientific-technical, educational, cultural, physical culture and sport, protect the environment, promote social initiatives to build roads and telecommunications network in rural areas and water supplies, charity, health and social welfare, vocational and social rehabilitation of disabled and religious) intended to so-called "preferred general objectives".

#### **Exemption for preferred companies income allocated in preferred targets**

According to the Corporate Income Tax Act revenues of the commercial companies are exempted from corporate income tax if the shareholders of these companies are associations or unions of associations whose statutory objectives are so called "preferred general objectives" (the same as described in the paragraph above), the exemption applies to income allocated to these so called "preferred general objectives" and to shareholders. It should be emphasized that the transfer to shareholders may be in the form of donations or by means of distribution of profits (dividends, redemption of shares / shares for a payment).

#### **Exemption for church legal entities**

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<sup>12</sup> E. Grzejszczyk, *Wybrane instrumenty systemu prawa podatkowego i finansowego w zakresie finansowania podmiotów ekonomii społecznej*, Analiza prawno-finansowa wg stanu prawnego na dzień 1 stycznia 2008 roku, p. 34-40.

According to the Corporate Income Tax Act the unconditional exemption applies to the whole church legal entities income from non-economic statutory activities.

Exemption also applies to income from other activities of church legal entities (business activity and operations not covered by the statute of church legal entities ) intended to so called "preferred targets of church" (objectives religious, educational, scientific, cultural, charitable, welfare and maintenance of monuments, conducting religious education, religious investments in the field of construction, development and reconstruction of churches and chapels, the adaptation of other buildings for the sacral purposes and other investments for catechetical and charitable care facilities).

Exemption from income tax also applies to commercial companies, whose shareholders are only the church legal entities, which income is designed to so called "preferred targets of church legal entities".

### **Exemption for public benefit organizations**

According to the Corporate Income Tax Act the exemption of public benefit organizations income intended for the statutory activities, with the exception of business activity ("intended for the statutory activities" includes both the funds allocated directly to the statutory objectives of the public benefit organizations, as well as the functioning of the public benefit organizations with the exception of business activity).

### **Exemption for income of Volunteer Fire Brigade**

Volunteer Fire Brigade income shall be exempt in part of the statutory purposes. Voluntary Fire Brigade can freely define in the statute the statutory objectives. This means that the Volunteer Fire Brigade may have statutory purposes other than public purposes and the exemption is also entitled to income that is not intended for socially useful purposes. Consequently, the exemption should be clarified.

### **The other similar objectively – subjective exemption**

Corporate Income Tax Act provides also the following exemptions:

- the exemption of the social co-operatives income distributed for the social or professional reintegration of its members,
- the exemption of the raffles and bingo games income that are intended entirely on socially useful objectives,
- the exemption of the school income spent for school purposes,
- the exemption of the sport clubs income spend for training and competition of children and adolescents.

### **Exemptions for enumerated social enterprises in a particular part**

According to the Corporate Income Tax Act exempt are also:

- income from the membership fee of the political, social and professional organizations – in the part not allocated to business,
- income of the labor union, social and professional organizations of farmers, agricultural chambers, employers' organizations and political parties - in part for statutory purposes excluding the business activity.

Due to the imperfection of the current legislation some changes are needed. E. Grzejszczyk proposals are shown below:<sup>13</sup>

- it should be maintained the exemption for church legal entities in its current form,
- it should be maintained the exemption for public benefit organizations income,
- it should be entered the exemption for social enterprises income which is allocated in specific public benefit purposes.

Proposed exemptions for social enterprises and exemptions considered as desirable are presented in the table 2.

**Table 1. Desired tax exemption of social enterprises**

No. of article	Content of the desired exemption
The requested exemption for social enterprises	Tax-free is social enterprises income referred to the regulations about activities of the social economy enterprises – in part allocated in purposes of public benefit provided by these companies.
Article 17.1.4a – b without changes	Tax-free are: church legal entities income: <ul style="list-style-type: none"> <li>- from non-economic statutory activities,</li> <li>- from other activities – in part for following purposes: religious, educational, scientific, cultural, charitable, welfare and maintenance of monuments, conducting religious education, religious investments in the field of construction, development and reconstruction of churches and chapels, the adaptation of other buildings for the sacral purposes and other investments for catechetical and charitable care facilities,</li> </ul> commercial companies income, whose shareholders are only the church legal entities, which income is designed purposes set out in point 4a, b).
Article 17.1.6c without changes	Tax-free is public benefit organizations income, which are mentioned in regulations about public benefit activity and volunteering – in part for its statutory activities with the exception of business activity.

Source: E. Grzejszczyk, *Wybrane, op. cit.*, p. 41.

The introduction of the proposed exemption of social enterprises income should be related to the removal of a number of existing exemption, which purpose would be much better achieved by exemption proposed in table 2 (the exemptions proposed to remove: article: 17.1.4, 17.1.4d, 17.1.5, 17.1.5a, 17.1.16).

## CONCLUSION

To support the development of the social enterprises the following actions should be taken:

- developing the financial support tools for social enterprises,
- introducing the tax incentives for social enterprises,
- introducing the preferential employment system for people moving from employment in social enterprises to the open labor market,
- creating an information base concerning the possibility of obtaining financial resources and management of the social enterprises,

<sup>13</sup> E. Grzejszczyk, *Wybrane, op. cit.*, p. 40.

➤ creating to social enterprises the opportunities to participate in training in finance and accounting, and specialized training corresponding to the profile of the company, the training of the organization of work, law, management, administration and EU funds.

It should be also emphasized the need for system changes to support the social entrepreneurship:

- the need for a law regulating the social enterprises and entities cooperating with them,
- the inclusion of social enterprises in the system of development, implementation and coordination of social policy
- creating an institutional support system (e.g. consulting, training, financial assistance),
- building a positive image of social enterprises.

The main conclusion from the research is the need to simplify the tax system and replace a number of existing tax exemption by introducing the tax- is social enterprises income referred to the regulations about activities of the social economy enterprises – in part allocated in purposes of public benefit provided by these companies.

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