

THE SOCIAL BUSINESS: THE VIABILITY OF A NEW BUSINESS ENTITY TYPE

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I. INTRODUCTION

Grameen Bank and Professor Muhammed Yunus won the Nobel Peace Prize in December 2006 for their ground-breaking work in microcredit and poverty reduction.¹ The Bank's mission is to decrease poverty in rural Bangladesh by granting small, collateral-free loans primarily to poor women villagers. The women qualify for loans by presenting a satisfactory business plan, learning how to sign their own names, forming groups with four other would-be borrowers,² and attending a week-long training program where they learn Grameen's social principles.³ A typical loan ranges from \$10-\$300. Business

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within one week of the proposal.⁹ The Bank also takes deposits for members' savings accounts, pension schemes, and loan and life insurance.¹⁰ Grameen Bank's success has been internationally recognized and its method is being replicated in many other countries around the world.¹¹

Grameen Bank was created as an independent bank through a special statute passed by the Bangladeshi legislature in 1983.¹² The Bank is currently owned 7% by the government and 93% by its borrowers, who purchase shares per capita for about \$1.50.¹³ The Bank is a nonprofit organization under Bangladeshi law, and it is exempt from income tax under the 1983 ordinance provided that it puts all its profits into a Disaster Fund, to be used for the benefit of its borrowers in the case of a natural disaster.¹⁴

The Bank has also created numerous "sister companies," most of which are organized not-for-profit, and some that are tax-exempt. The sister companies include ventures in preschool education, the garment industry, renewable energy, and fortified yogurt manufacturing. These sister companies all share the Grameen name and the Grameen mission of improving the condition of the rural poor through loan- and business-oriented solutions rather than charity handout programs. These companies have already created 2800 well-paying jobs in a factory adhering to all government safety and benefits standards¹⁵ and equipped over 100,000 rural homes and businesses with clean and reliable solar energy,¹⁶ among a myriad of other social benefits.

Grameen has revolutionized Bangladesh through its focus on women and its philosophy of believing in the capabilities of the poor. Grameen Bank has so many members and such an influential social agenda that it can be said that "Bangladesh has two governments," the

9. Interview with Ahmed Fais, Amdala Branch Manager, Grameen Bank, in Bangladesh (June 24, 2007).

10. *Id.* at 1-2.

11. YUNUS, *BANKER TO THE POOR*, *supra* note 3, at 181-194.

12. The Grameen Bank Ordinance, Ord. XLVI § 1 (1983) (amended 1995); *see also* Interview with Golam Morshed Mohammed, International Programmes Department Coordinator, Grameen Bank, in Bangladesh (July 8, 2007).

13. Interview with Golam Morshed Mohammed, International Programmes Department Coordinator, Grameen Bank, in Bangladesh (July 8, 2007).

14. *Id.*

15. Interview with Redwanul Haque, Manager, Grameen Knitwear, in Bangladesh (July 13, 2007).

16. Interview with Md. Fazley Rabbi, Engineer, Grameen Shakti, in Bangladesh (July 10, 2007).

national government and Grameen Bank.¹⁷ Grameen is completely free from dependence on government grants and now declines all donor funds. It is a self-sufficient financial institution that has created a new and lucrative market in lending as a by-product of its mission to end poverty in Bangladesh. While the beneficial work and success of Grameen Bank is obvious, if the Bank was organized under US law, its tax-exempt status would be precarious, threatening the viability of the entire enterprise as a result.

The current state of US charitable tax exemption law is muddled at best, and impenetrable at worst. In the US, the Bank would be in danger of running afoul of numerous exemption doctrines, including the exempt purpose requirement, the commerciality doctrine, the private benefit doctrine, the prohibition against certain joint ventures, the Unrelated Business Income Tax (UBIT), and the Excess Benefit Tax (EBT). These doctrines and rules will be discussed in turn, however, a general theme emerges that is worth noting initially: these doctrines reflect a policy of preventing charities from behaving too much like businesses. Although the benefit of federal tax exemption should not be available to commercial businesses, such a policy against commerciality in general severely limits the breadth of innovation and potential funding sources accessible to American charities and nonprofit organizations, which provide essential services and employment opportunities to the poorest Americans.

The current legal framework in the US does not encourage, or even allow, many forms of entrepreneurship or profitable activities within exempt organizations. Professor Yunus has proposed the creation of a new type of business entity, called the “social business,” to fill this legal and intellectual gap.¹⁸ Social business may not fit into the popular or legal definitions of “charity” or “business.”¹⁹ Instead, social businesses will be encouraged to pursue both social and economic goals. The bifurcated system of exempt or non-exempt, nonprofit or for-profit, simply does not create a hospitable legal environment for social entrepreneurs to develop private, self-sustaining solutions to poverty and other pressing societal problems that are arguably

17. See STEPHEN C. SMITH, *ENDING GLOBAL POVERTY: A GUIDE TO WHAT WORKS* 66 (2005). While the original quote references BRAC, another micro-credit institution in Bangladesh, the sentiment equally applies to the influence of Grameen Bank.

18. Yunus, *Nobel Lecture*, *supra* note 1, at 272.

19. See Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 *VILL. L. REV.* 433, 467-468 (1996); Bradley Myers, *Revisiting the Commerciality Doctrine*, 10 *J. AFFORDABLE HOUSING & COMMUNITY DEV. L.* 134, 138 (2001).

within the province of the government to fix.²⁰ Charity law in the US is in need of a paradigm shift by which we encourage business-oriented solutions to poverty and social problems, and the creation of a new legal form of business could precipitate this paradigm shift.²¹

In Part II of this article, I will explore the current conundrum of non-profit tax law, and the “double-bind” charities face as government funding continues to wane.²² In Part III, I will explain the shortcomings of the current legal framework for US charities and then discuss Professor Yunus’s proposal to facilitate socially conscious entrepreneurial solutions to social problems. In Part IV, I will suggest some general legal parameters for the social business form, reflecting current U.S. policy toward private charities, and advocating for the adoption of some new policies as well.

II. THE CURRENT STATE OF NONPROFIT LAW AND THE CHARITABLE TAX EXEMPTION

Besides the obvious problem of constant pressure to raise funds for operating expenses, American nonprofit organizations face many challenges and legal uncertainties which presumably decrease their reach and effectiveness. First, despite an increased reliance on nonprofits to provide quasi-governmental social services to the poor, the nonprofit sector’s access to federal funds is severely limited, and has been since federal budget cuts in the 1980s.²³ Second, an increasing number of nonprofits must compete for scant resources to stay afloat.²⁴ Third, and perhaps most important, the current state of the law regarding the charitable exemption from federal income tax is chaotic and unpredictable, causing nonprofit organizations to guess at whether they will be able to obtain tax exemption.²⁵ With corporate tax rates ranging from 15-35 percent,²⁶ an adverse ruling from the IRS regard-

20. See Yunus, *Nobel Speech*, *supra* note 1, at 272 (“By defining ‘entrepreneur’ in a broader way we can change the character of capitalism radically, and solve many of the unresolved social and economic problems within the scope of the free market.”). See also *Bob Jones University v. U.S.*, 461 U.S. 574, 590 (1983) (noting the policy behind providing tax exemption to organizations operating in the traditional sphere of the government).

21. Yunus, *Nobel Speech*, *supra* note 1, at 271.

22. Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America’s Tangled Nonprofit Law*, 73 *FORDHAM L. REV.* 2437, 2438 (2005).

23. Heather Gottry, Note, *Profit or Perish: Non-Profit Social Service Organizations & Social Entrepreneurship*, 6 *GEO. J. ON POVERTY L. & POL’Y* 249, 252-253 (1999).

24. *Id.* at 251-255.

25. Kelley, *supra* note 22, at 2473.

26. I.R.C § 11(B)(1)(a)-(d) (2006).

na,³⁴ the nonprofit sector plays a primary role in providing social services to the poor, with the apparent blessing of the government and the general public.³⁵ Thus, the charitable tax exemption performs a vital function in the social service sector in the US. Even though government policymakers clearly want to encourage private social service providers (as evidenced by the charitable tax exemption),³⁶ the IRS is not wont to give up revenue, and therefore has developed a series of rules and tests to create a narrow category of exempt organizations. The voluminous contours and complexities of the charitable tax exemption have been documented by many authors and scholars.³⁷ What follows is a brief overview of the central doctrines and facets of the law most pertinent to the present discussion.

1. The Organizational and Operational Tests

In order to qualify for federal income tax exemption, an organization must be:

[O]rganized 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 . . . , and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in oppo-

34. See YUNUS, *BANKER TO THE POOR*, *supra* note 3, at 219 (Professor Yunus goes further to say that governments generally

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“[purchase], import, and sale of handicrafts” of disadvantaged artisans, which furthered exempt purposes such as promoting stabilization in developing countries whose economies rely on handicrafts.⁵⁴ Aid to Artisans’s commercial activity did not prevent a finding of exemption because the organization simply used commercial means to further permissible exempt purposes.⁵⁵

The Tax Court also looked at Aid to Artisans’s furtherance of non-exempt purposes, because it was probable that some non-disadvantaged artisans would enjoy the benefits of the programs as well. The court found that the number of non-disadvantaged artisans benefited was low, and affirmed that the “presence of insubstantial nonexempt purposes is no bar to exemption.”⁵⁶ However, this “substantiality” inquiry does not provide an entirely clear guideline.

For example, in *Federation Pharmacy Services, Inc. v. Commissioner*, a nonprofit pharmacy organized to give discounts on prescriptions to elderly and disabled patients was denied tax-exempt status.⁵⁷ The pharmacy provided discounts to an amorphous class of beneficiaries without specific provision for those who could not pay, and the court found that carrying on a regular trade or business with altruistic or charitable motivations was not enough to qualify the organization for exemption.⁵⁸ Federation Pharmacy’s activities were found to substantially further a nonexempt purpose, the sale of prescription drugs for a profit, so it was denied exemption.⁵⁹ While some commercial purpose is allowed, the court has discretion to weigh the substantiality of nonexempt purposes (like profit-making) against exempt purposes.⁶⁰

b. Commerciality Doctrine

Even if an organization that engages in some commercial activity meets the exempt purpose tests, it may still be denied exempt status if it does not meet the ambiguous requirements of the commerciality doctrine. The commerciality doctrine controls “the types of

54. *Aid to Artisans*, 71 T.C. at 212-213.

55. *Id.*

56. *Id.* at 214 (citing *Better Business Bureau of Wash. D.C. Inc. v. United States*, 326 U.S. 279, 283 (1945)).

57. *Fed’n Pharmacy Services, Inc. v. Comm’r*, 625 F.2d 804, 809 (1980).

58. *Id.* at 808-809.

59. *Id.* at 809.

60. *Id.*

businesses that a tax-exempt entity can operate to support its tax-exempt purpose,” and requires that “a ‘commercial enterprise,’ no matter how beneficial its intent, may not be the main purpose of a tax-exempt entity.”⁶¹ It is immediately clear how similar this doctrine is to the exempt purpose rules, and it appears to exist concurrently with and independently of the general exempt purpose rules. The commer-

Trinidad v. Sagrada Orden de Predicadores.⁶² In this case, the IRS argued that the Sagrada Orden should be denied exemption because it operated not only for exempt purposes (religion and education), but also for business purposes (income from real property and selling wine and chocolates).⁶³ The Supreme Court upheld the Order’s exemption on the basis of the now defunct “destination of income” test,⁶⁴ because all the profit from the Order’s commercial ventures went directly toward funding its exempt activities.⁶⁵

In 1945, the Supreme Court reflected a changing view toward the commercial activities of nonprofits in *Better Business Bureau of Washington D.C. v. United States*.⁶⁶ The Supreme Court denied the Bureau’s exemption based in part on the overall “commercial hue” of the organization.⁶⁷ In a later case involving a religious publisher, the court asked whether “the sale of religious literature [was incidental] to the [publisher’s] religious purposes” or whether the publisher’s exempt religious purposes were “incidental to the sale of religious literature.”⁶⁸ The court held that the publisher’s primary purpose was the actual sale of religious literature, and so denied exemption.⁶⁹ Other non-profit organizations have struggled to penetrate the enigmatic test

It appears that the commerciality doctrine embodies a principle, whether popular or legal, that “a lack of commercial or business activity [is] a prerequisite to tax-exempt status.”⁷² Even when commercial activity relates to a charitable purpose,⁷³ or when “commercial means are used to achieve . . . charitable purposes,”⁷⁴ the organization’s tax exempt status may be called into question. It is difficult for organizations to know when or how the commerciality doctrine will be applied, and the fate of tax-exempt organizations who engage in commercial activity “remains largely subject to the whims of the IRS and the courts.”⁷⁵

c. Private Benefit Doctrine

To qualify for exemption, an organization must benefit a charitable class and serve public rather than private interests.⁷⁶ In *Aid to Artisans*, the IRS argued that the organization only served the private interests of the individual artisans whose handicrafts they sold.⁷⁷ The IRS claimed that the organization acted like a commercial import firm and merely bought handicrafts at market prices from artisans.⁷⁸ However, the court rejected this characterization and recognized the broader charitable purposes of a commercial import enterprise, including “the benefit which the public derives” from the employment of disadvantaged artisans and the overall stabilization of fragile economies.⁷⁹ In *Industrial Aid to the Blind v. Commissioner*, the court allowed exempt status for a nonprofit organized to promote employment opportunities for the blind even though the blind employees were given biannual bonus checks based on the performance of the

72. *Id.*

73. *See, e.g., Fed’n Pharmacy Services, Inc., v. Comm’r.*, 625 F.2d 804, 806 (1980) (concerning an organization that had as its mission the operation of a discount pharmacy business).

74. *See, e.g., Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578, 582 (1924) (under today’s law the unrelated commercial business enterprises used to support the charitable mission of the Sagrada Order, would probably be taxed under the UBIT, discussed *infra* Part II.A.2, or jeopardize tax exempt status altogether).

75. Myers, *supra* note 19, at 146.

76. Treas. Regs. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 1990) (“[I]t is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”).

77. *Aid to Artisans, Inc. v. Commissioner*, 71 T.C. 202, 208 (1978).

78. *Id.*

79. *Id.* at 215 (citing *Trinidad*, 263 U.S. at 581).

business.⁸⁰ The court found the practice of giving bonuses incidental to the primary activities of the organization and determined that the bonuses actually furthered the organization's exempt purposes.⁸¹

The IRS also uses the private benefit doctrine to regulate individual transactions between exempt and non-exempt entities.⁸² Under the private benefit doctrine, the IRS balances "public versus private benefit in making case-by-case determinations regarding whether particular transactions [violate] the private benefit doctrine . . . [applied to] any economic arrangement with persons or entities outside the charitable class," and not just to transactions with insiders as under the private inurement doctrine.⁸³

In *American Campaign Academy v. Commissioner*, a school that trained individuals to work on political campaigns was denied exemption even though it was organized for educational purposes under I.R.C. § 501(c)(3).⁸⁴ Although the school did not limit admission, most of the graduates eventually worked for the Republican Party, so the court found that "the school benefited the private interests of the Republican Party to an impermissible degree."⁸⁵ The private benefit rules, however, tend to bleed into the prohibition against private inurement, and "considerable historic confusion regarding the scope of the private benefit doctrine" persists to this day, leading to uncertainty and uneven application.⁸⁶

d. Joint Ventures

Nonprofits may also face challenges to their exempt status if they enter into joint ventures, such as partnerships or LLCs, with non-exempt entities. In basic terms, a joint venture is an enterprise, jointly taken, where all parties agree to contribute some assets or capital, share control, and share in the profits and losses.⁸⁷ A partnership between a nonprofit and for-profit entity highlights the incompatibility of the existing legal framework to the efficient development of the market: the law requires that a nonprofit entity prevent private indi-

80. *Indus. Aid for the Blind v. Comm'r*, 73 T.C. 96, 102 (1979).

81. *Id.*

able.¹⁰³ Because the UBIT does not tax related business income, the argument that its purpose is to prevent unfair competition is somewhat dubious,¹⁰⁴ and an exempt organization will enjoy the tax advantage above other firms in areas related to its exempt purpose (e.g., hospitals). Additionally, exempt organizations may follow certain hiring principles or favor certain unreliable clientele, even in their unrelated business, so the unrelated business may not otherwise truly compete with its non-exempt counterparts.¹⁰⁵

Like the other charitable tax doctrines, many intricacies and tiered tests plague UBIT law. First, the IRS taxes income if it is not “substantially related” to the exempt entity’s performance of its exempt purpose.¹⁰⁶ This substantial relationship exists if a causal relationship between the activity and the exempt purposes is found, and if the business activity “contribute[s] importantly to the accomplishment of those purposes.”¹⁰⁷ Additionally, if an exempt organization pays the UBIT on an unrelated trade or business, the organization will have to discern what level of unrelated activity is actually insubstantial, because if the unrelated activity becomes substantial, the entity will lose exemption altogether.¹⁰⁸ The UBIT reflects a policy that nonprofits should be able to engage in at least some commercial activity related to their exempt purposes.¹⁰⁹ However, the doctrine is based not on actual threats of unfair competition, but instead on popular and legal conceptions of how charities should function (i.e., not like businesses).¹¹⁰

103. *Id.* at 1551 (citing Proposed Revisions of the Internal Revenue Code: Hearings Before the H. Comm. on Ways and Means, 80th Cong. 3536 (1947) (“I know New York University pretty well and there is nothing that they teach in New York University that is incidental to spaghetti.”)).

104. *Id.* at 1495-96.

105. See Gottry, *supra* note 23, at 258-59 (nonprofits have pressure to pay higher, living wages to employees, and often use enterprises as a way to provide employment and job training to disadvantaged individuals, and nonprofits are bound to work toward their social aims, just like corporations are bound to work toward profits).

106. I.R.C. §§ 511, 513(a) (2006).

107. Treas. Reg. § 1.513-1(d)(2) (as amended in 1983).

108. Mirkay, *supra* note 37, at 33.

109. *Id.* at 60 (citing John D. Colombo, *A Framework for Analyzing Exemption and UBIT Effects of Joint Ventures*, 34 EXEMPT ORG. TAX REV., Nov. 2001, at 188). See also Gottry, *supra* note 23, at 250-51 (“[S]ome critics do not believe that the tax adequately addresses the advantage gained from tax-exemption for activities that do fulfill the non-profit’s pur-

ing them with employment opportunities and education, the Bank's main activity is decidedly money-lending: Professor Yunus insists that the poor need only the most minimal training and oversight, and instead simply need access to capital in order to improve their lives.¹¹⁸ Is the Bank's primary activity, lending money at 20% interest, in furtherance of its exempt purpose? Does the commercial purpose of the Bank rise to the level of substantial? The Bank has been commercially profitable since 1995 and rejects all donor funds,¹¹⁹ a sometimes pivotal question for exemption.¹²⁰ Grameen has alliances with for-profit entities, like Dannon Foods,¹²¹ which has French scientists working at the plant in Bangladesh and which will receive back its entire initial investment in the small yogurt factory when the business becomes viable.¹²² Are these factors indicia of Dannon's joint control over the venture? Grameen's 23 sister companies essentially trade interest-bearing loans with each other when they need capital.¹²³ Professor Yunus is the Chairman of the Board of 14 of these companies.¹²⁴ This arrangement is ripe with issues under the private benefit and excess benefit doctrines.

While some might dispute whether Grameen Bank is actually a "charity" in the traditional sense, the Bank clearly provides a desired social benefit.¹²⁵ The US should seek a hospitable legal environment

118. YUNUS, *BANKER TO THE POOR*, *supra* note 3, at 215.

119. Interview with Golam Morshed Mohammed, International Programmes Department Coordinator, Grameen Bank, in Bangladesh (July 8, 2007).

120. *See Fed'n Pharmacy Services, Inc. v. Comm'r*, 625 F.2d 804, 808 (1980) (citing cases in which "the absence of contributions or of a plan to solicit contributions, which are characteristic of a charitable institution, militated against the finding of tax-exempt status for those respective organizations").

121. Dannon Foods Press Release, *Launching of Grameen Danone Foods Social Business Enterprise*, Mar. 16, 2006, available at http://www.danone.com/cmscache/MYSESSION~C18BEC37655BCF6EC12571330043EC9E/CP_1600306_GB.pdf.

122. Interview with Immamus Sultan, Manager, Grameen Danone, in Bangladesh (July 10, 2007).

123. Interview with Golam Morshed Mohammed, International Programmes Department Coordinator, Grameen Bank, in Bangladesh (July 8, 2007).

124. *Id.*

125. The author is aware that Grameen Bank performs what some might say are quasi-governmental functions (providing subsidies to the poor) in a country where the government does not perform governmental functions as well as the U.S. government does. However, it is clear that the government in any country is not obligated to provide microloans and sustainable business opportunities to the poor. *But see* Interview with Abdul Hai Khan, Program Director, Grameen Trust, in Bangladesh (July 9, 2007) (the Bahrainian government is currently working on a project with Grameen Trust to start a microlending project in lieu of the national welfare

that have a commercial aspect, preventing socially desirable services from further development.¹³³

According to Professor Muhammed Yunus, entrepreneurs should act as leaders in poverty eradication and the social service sector. He argues for the abandonment of “the assumption that entrepreneurs are one-dimensional human beings, who are dedicated to one mission in their business lives—to m

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it altogether.”¹⁴²

The other type of social business focuses on “providing a social benefit rather than on maximizing profit for the owners.”¹⁴³ This type

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erty.¹⁵² Corporations must spend money to market their products and services, create positive public relations, and buy necessary goods and services to facilitate their own production.¹⁵³ Social businesses create an ideal channel for corporations to create associations with and purchase goods and services from socially-conscious enterprises that seek to maximize social benefit.¹⁵⁴ The social business represents the ideal meeting point for directing business profits and expenditures toward socially beneficial activities.¹⁵⁵

IV. THE SOCIAL BUSINESS ENTERPRISE IN AMERICAN LAW

Although Professor Yunus argues that the role for government in providing social services is somewhat limited, he argues that the government should decidedly advocate “policy packages encouraging businesses to move in the socially desired direction, providing incentives to social-consciousness-driven enterprises encouraging competitive spirit and strength in the social consciousness-driven sector.”¹⁵⁶ Creating the social business as a new entity distinct from both corporations and nonprofits will give effect to such a policy. The social business will be characterized by the freedom to pursue social goals and also make a profit while engaging in commercial activities.¹⁵⁷ It should receive certain benefits traditionally given to nonprofits to encourage it to seek social goals, but it should also have to adhere to some of the requirements placed upon corporations to prevent corrupts to specific
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could even be expanded for the social business in order to increase its competitiveness in the market because social businesses will pay some tax to the government and will be more transparent than exempt nonprofits due to disclosure requirements.¹⁶⁸

The social business will freely engage in commercial activities, and the commerciality doctrine will not transfer into social business law.¹⁶⁹ Creation of a social business entity that enjoys favorable tax treatment presents the difficult issue of determining and enforcing exactly how much of the business' motivation can be purely profit and how much must be for exempt goals. In order to address this concern,

overall market efficiency.¹⁷⁵ Similarly, a social business entity type will allow freer formation of alliances and partnerships with other for-profit (or nonprofit) firms.¹⁷⁶ A major benefit to this greater leeway would simply be the cost saved in having to litigate the fine details of every imaginable type of joint venture arrangement.¹⁷⁷

In the same way, the EBT should not apply as strictly in social business law because the efficiency of the market will increase by expanding the number of potential transactions into which a social business could enter.¹⁷⁸ However, it may be useful to apply some sort of requirement, akin to private inurement or corporate insider trading laws, that regulates transactions with insiders to some degree.

C. UBIT

The UBIT will not apply to social businesses, because one of the aims of social business is to encourage entrepreneurs to approach funding creatively and engage in efficient transactions with all types of entities.¹⁷⁹ A social business will have the freedom to cross-subsidize its charitable work through unrelated business activities.¹⁸⁰ Social businesses will not have an unfairly competitive edge over for-profit firms because social businesses' entire income will be taxed, and they will not operate as efficiently as for-profit firms because they have social goals balancing out profit-making goals.¹⁸¹

D. Raising Capital

All firms, for-profit, nonprofit, and social business, must have access to capital in order to start and maintain their operations. For-profit firms offer investors attractive dividends and profit-sharing arrangements. Nonprofit firms offer their investors the charitable tax deduction. A social business could not offer investors either of these

175. See Brody, *supra* note 19, at 433.

176. See generally Mirkay, *supra* note 37, at 68.

177. See, e.g., Plumstead Theatre Soc'y, Inc. v. Comm'r, 74 T.C. 1324 (1980); Indus. Aid for the Blind v. Comm'r, 73 T.C. 96 (1979); Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978); Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578 (1924). See generally Mirkay, *supra* note 37.

178. See generally YUNUS, BANKER TO THE POOR, *supra* note 3, at 217 (advocating the social business framework because "the market needs ruc0.0533 Tw[(, supraOe)]TJ17.0 Tw(177)Tjc2coulc.1149 Tw Tc0.0014 Tw[(f

tional governance and perhaps, less accountable to constituencies being serviced by the public as a whole.”¹⁸⁹ Rather than weakening the reasons for social business, the accountability argument supports the creation of social business. Social services are increasingly being privatized.¹⁹⁰ Encouraging some private social service providers to become social businesses will actually increase the transparency of the private social service sector since social businesses would comply with disclosure requirements.

Lawmakers, lawyers, scholars, and the public may argue against increasing an already complicated area of the law by creating a new hybrid business entity type.¹⁹¹ Because nonprofit law is already practically impenetrable, any change could only serve to simplify its application. Firms that clearly fall within the established parameters of charitable exemption laws would likely gravitate toward the existing nonprofit categorization, and firms that are less clearly exempt may gravitate toward the social business category, where the existing exempt entity standards and tests can be used, but at a more relaxed level.

Another potential argument against social business is that the LLC form already allows businesses to pursue social and profit-seeking goals at the same time. This argument, however, misses the point of the new social business entity. Current law, LLC law included, does not *encourage* charities and social service providers to be entrepreneurial and creative. LLC law allows more flexibility in the motives of the entity, but suffers some hindrances in the ability to raise capital and grow, and does not mandate disclosures or provide any favorable tax treatment for pursuing social goals. The LLC currently represents the most viable option for social entrepreneurs in the US, but it is an imperfect one:¹⁹² a social entrepreneur must choose between the charitable tax exemption and the freedom to structure operations in a commercial way.

Another argument against the creation of social business is that

189. Susan R. Jones, *Current Issues in the Changing Roles and Practices of Community Economic Development Lawyers*, 2002 WIS. L. REV. 437, 438 (2002).

190. See generally Gottry, *supra* note 23, at 251-55.

191. See generally Brody, *supra* note 19, at 490-95 (arguing that the nonprofit sector is already too large).

192. The social entrepreneur who organizes an LLC will likely never reach Professor Yunus' superior status as a "Social Business Entrepreneur," or a social entrepreneur who runs a business with full cost recovery or beyond. Yunus, *Social Business Entrepreneurs*, *supra* note 1376.

nonprofits will lose their market and their resources to the social businesses. This may be true, but the creation of a new business entity means that some nonprofits (and some corporations) will simply become social businesses if that form provides the best options for the entity's efficiency and viability.¹⁹³ Perhaps social businesses will concentrate in particular industries so that the competition factor is not an issue. Additionally, social businesses will pay tax on all their income, which should dispel some concerns about unfair competition with other nonprofits.¹⁹⁴

Corporations may object to the lower tax rate for social businesses. While the countervailing social motivations and disclosure requirements should serve to allay some of these concerns,¹⁹⁵ to an extent, this argument simply becomes a question of what policy American charitable law ought to reflect. I would advocate for a policy that gives businesses with an appropriate social motivation favorable tax treatment. Obviously, as evidenced by the existence of the UBIT, many lawmakers may disagree.¹⁹⁶ However, the ideal of a truly free market is simply an illusion, as it will remain as

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American charity law is inhospitable to social-consciousness-driven entrepreneurship.¹⁹⁷ However, creating a new type of business entity could precipitate a paradigm shift in the way we understand charities and the provision of social services. Certain commercial nonprofits would not need to be called “charities,” but could be called “social businesses.” This paradigm shift would free us to think more strategically and entrepreneurially in the fight against poverty and society’s most pressing problems.¹⁹⁸ Social business offers an inspiring solution to the needs the charitable exemption was created to meet. By changing the legal framework of business entity law, we create the opportunity for social entrepreneurs and the poor themselves to eradicate poverty. “Poverty is not created by the poor, it is created by the structures of society, and policies pursued by society. Change the structure . . . and you will see the poor change their lives.”¹⁹⁹

197. YUNUS, BANKER TO THE POOR, *supra* note 3, at 213.

198. Yunus, *Nobel Speech*, *supra* note 1, at 271-72.

199. YUNUS, BANKER TO THE POOR, *supra* note 3, at 215.