SOCIAL ENTREPRENEURSHIP

Is it social or entrepreneurship? Tax treatment of social entrepreneurship in Switzerland

Raphaël Gani

1 Introduction

In Switzerland, legal tax-exempt entities are exhaustively listed in the law (Oberson/Hull, 2011, p. 41). Such an exemption includes institutions of public or private law to the extent that they are dedicated to purposes in the public or cultural interests. It classically applies to charity-type entities that are completely “not-for-profit.” On the contrary, “for-profit” entities are subject to full corporate tax on profit and capital. In recent decades, in Switzerland, as in other developed countries, a hybrid form of entities that blurs the boundaries of the classical binary model (for- or not-for-profit) has emerged. For these social entrepreneurs, generating revenue (clearly outside profit maximization) from their enterprises is a key driver, ensuring financial sustainability, generating returns for investors, and avoiding the need to rely on charitable donations or grants. Even if they consider generating revenue, their purpose remains in the public interest, as they pursue a mission solely focused on the promotion of public benefit purposes.

This hybrid characteristic may, as we shall see under the current Swiss tax environment, prevent them from benefiting from a tax exemption (the hybrid nature of the social entrepreneur may also carry some problems in other fields of the tax law, like VAT: see, Vogelsang, 2021, p. 501). We therefore explore which conditions to fulfill under Swiss tax law and, in particular, which could be an obstacle for those social entrepreneurs.

2 Notion of social entrepreneurship and selected model

The notion of social entrepreneurship is difficult to precisely define. Recent research indicates that the conceptualization and definition are differentiated under the applicable subject and methodology (Shapovalov *et al.*, 2019). Broadly defined, social entrepreneurship is the field in which entrepreneurs tailor their activities to be directly tied to the ultimate goal of creating social value. In doing so, they often act with little or no intention to gain personal profit (Abu-Saifan, 2012; Zahra *et al.*, 2008). In this sense, “the social entrepreneur is a mission-driven individual who uses a set of entrepreneurial behaviors to deliver a social value to the less privileged, all through an entrepreneurially oriented entity that is financially independent, self-sufficient, or sustainable” (Abu-Saifan, *op. cit.*, 2012).

As this definition is too broad to examine whether a tax exemption is possible under the current Swiss tax environment in each particular case, we arbitrarily select a special model of social entrepreneurship among this definition. Indeed, among these social enterprises, there are companies in the technology sector that are considering developing devices specifically for the world's poorest countries or that are seeking a medicine for diseases that are only found in such countries. These markets are commercially unattractive to ordinary market oriented enterprises because customers are not able to pay a high price. Therefore, there is a lack of research and development in this sector, which requires a social enterprise to take an interest in it.

These companies generally operate with start-up capital that comes from a donation or public or private subsidy. With this seed money, development is conducted, and, in the best case, a product is developed and then sold at a price that is just enough to cover research and production costs and to enable the company to start researching a new product or drug. It is a production and selling model with a minimum margin, clearly having its place in development policies.

3 Current tax environment under Swiss tax law

Under current Swiss tax law, the granting of an exemption for public utility or public service purposes is subject to the fulfillment of several conditions. Under the terms of Article 56, let. g of the Direct Federal Tax Act (DFT), legal persons pursuing public service or pure public utility purposes are exempt from tax on profits exclusively and irrevocably allocated to these purposes (first sentence). The law adds the following: “economic purposes cannot, in principle, be considered to be of public interest” (second sentence). We first examine the general and specific conditions (3.1 to 3.2) and then will specifically analyse the prohibition of economic purpose (see Section 3.3). The practice of the Swiss tax authorities is reflected in circulars that are available online (in particular, “2008 Circular”; and the “Circular AFC, 1994”).

3.1 General conditions

The tax exemption of a legal person on the basis of Art. 56 (g) DFT presupposes the fulfillment of three cumulative *general* conditions: being a legal person, the exclusive and irrevocable use of the funds, and the effective continuation of the activity in accordance with its articles of association.

3.1.1 Being a legal person

This condition is not as innocuous as it may seem at first glance. Of course, this means that an entity applying for exemption must be incorporated in a legal form. The type of entity does not matter (foundation, association, or even corporations, like Swiss *société anonyme*, *société coopérative*, or another type of legal person), provided that it is a legal person. Nevertheless, this raises the question of trusts. Thus, if a trust, by definition now governed by foreign law, carries out activities that may be exempt in Switzerland, it is not certain that it can be tax exempted; it is not a person under Swiss law. However, this condition demonstrates another essential point of the Swiss legal framework: the exemption applies to entities and not to activities.

3.1.2 Exclusive and irrevocable use of funds

The funds must be used purely for public purposes. This allocation must be exclusive and irrevocable. The means must exclusively serve the exempted purpose and not be used for any other statutory purpose. The allocation of funds is irrevocable when the available means cannot

be returned to the founders or donors. This destination of the funds must be made in an irrevocable provision contained in the founding act of the legal entity. This condition may be relatively easy to fulfill for entities that are not owned by anyone. For example, a foundation or an association has only assets for the former or members for the latter. In such cases, it is sufficient to state in an irrevocable statutory clause that the funds will revert upon dissolution of the entity to another legal person, which will also be exempt for a similar purpose. This condition appears to be more complicated for corporations. Indeed, the funds initially entrusted (share capital) are remunerated in the form of dividends. According to the Circular AFC 1994, corporations that pursue purely public utility purposes must renounce, in their articles of association, distributing dividends and directors' fees (on this last point, see Section 3.2.2). However, it seems that this element mixes the irrevocable allocation of capital and its remuneration. A stock company should not be prohibited from remunerating its shareholders, but the articles of association should irrevocably provide that the funds initially made available may not be distributed. Furthermore, on liquidation, as in the case of a foundation or an association, the initial capital must be allocated to another entity benefiting from a similar exemption.

Regardless of the existence or lack of a limitation to the distribution of a dividend for companies, this element should not constitute a significant obstacle for the social enterprise. Indeed, in the model chosen previously, the initial financing can be carried out either as "non-refundable" in the form of a subsidy or a donation or in the form of an equity investment. In the first hypothesis, there is, by nature, neither the return of funds to the investor nor remuneration for the donation.

In the second hypothesis, it may occur in practice that the investor who wants to invest in a hybrid social enterprise is attracted by its social function but nevertheless demands some form of remuneration for its funding. In practice, it is often the case that this investor agrees to a lower return than they could obtain from an ordinary commercial enterprise but nevertheless demands a return. In such cases, it should be noted that the previously mentioned practice of the tax administrations presents an obstacle, since it appears to prohibit any payment of dividends. In our view, this prohibition is not related to the principle from which it is supposed to derive, which is the irrevocability of the funds allocated to fulfill the statutory purpose. Thus, it should not be strictly prohibited to distribute a dividend but rather limit the distribution in relation to the outlay so that the "social" investor can still obtain a limited form of remuneration, without which they will not make the investment.

3.1.3 Effective continuation of the activity

The purpose according to the articles of association must be the same as that actually fulfilled in reality. In this sense, there is no point in indicating as a statutory aim of pure public utility while pursuing a different aim, whether it is profit-oriented or not. There is also no actual purpose if no activities are carried out at all, and the funds are only hoarded. The prohibition of the accumulation of assets has been emphasized in case law (in particular ATF 120 Ib 374 consid. 3a p. 377) on the grounds that hoarding removes the altruistic character of the institution in question. The question of whether an entity devotes sufficient resources to the pursuit of its statutory aims or, on the contrary, has hoarded its assets, is in principle a question of accounting. An operating loss should hence exclude any claim of hoarding (cf. RDAF 2016 II 144 recital 5.5.3). In the aforementioned judgment, it was thus held that an entity that allocated 1/3 of its profits to its corporate purpose was not deemed to be accumulating assets. Distributing 62,000 fr. in a financial year in which a profit of 156,428 fr. was made "cannot represent a fraction out of proportion to its means." If, as indicated by case law, the examination of whether the statutory

purpose is actually being pursued is made with regard to the use of profits (and not with regard to available assets), the criterion must be deemed to have already been satisfied in the case of a loss over a financial year.

This condition is not a specific problematic of social enterprises. Any entity benefiting from a tax exemption may prove problematic if the entity cannot immediately start its activity of pure public utility.

3.2 Specific conditions

In addition to these three *general* conditions, in accordance with the text of Article 56. g DFT, it is necessary that the legal entity pursue either *a public service* or *pure public utility*. Hence, Swiss tax law distinguishes between these two types of activities that are eligible for tax exemption, on the one hand, activities of pure public utility and, on the other hand, public service activities. Each of these types of activities must meet specific conditions; for example, an exemption for an activity of pure public utility will not be exempted under the same conditions as a public service activity (Federal Supreme Court, case 2C_147/2019 of August 20, 2019, and case 2C_740/2018 of June 18, 2019). According to case law, an exemption based on a public service purpose must be interpreted restrictively. A legal person pursues public service goals if it performs tasks closely related to state tasks (cf. ATF 131 II 1, recital 3.3. p. 6; case 2C_740/2018 of 18 June 2019, recital 5.3).

Exemption based on the pursuit of purely public utility objectives, which is our selected case (see previously 2.), presupposes the fulfillment of two more specific conditions, namely the exercise of an activity in the general interest in favor of an open circle of recipients and disinterestedness (Federal Supreme Court, cases 2C_484/2015 of December 10, 2015, recital 5.3 and 2C_251/2012 of August 17, 2012, recital 2.1).

3.2.1 General interest

According to the Circular AFC 1994 (p. 2), activities of charitable, humanitarian, health, ecological, educational, scientific, and cultural nature may be considered to be of general interest. For example, public assistance, the arts, science, education, the promotion of human rights, the safeguarding of heritage, the protection of nature and animals, and development aid are likely to promote the general interest. Public utility presupposes that the entity carries out an activity in the general interest (as opposed to selfish individual interests), that is, an activity that serves to promote the interests of the community and meets the needs of a significant part of the population (Urech, 2017, art. 56 LIFD N 60). It must be an activity that is particularly worthy of encouragement and support according to the conception of a significant part of the population, one which is carried out for the good of the community. The general interest should not necessarily be confused with the (presumed) interest of a majority of the population, nor with the activities normally carried out by the state.

In the leading case, ATF 113 Ib 7 (= RDAF 1990, p. 197) concerning the “Welttheatergesellschaft Einsiedeln,” the Federal Court confirmed that the elements constituting the exemption on grounds of public utility must be interpreted strictly and that it does not cover every activity enriching the community in cultural terms. In particular, the condition of “public utility” cannot be considered as satisfied in the presence of events which constitute a pure entertainment. In addition, an association of public utility cannot simply be tax exempted because it receives subsidy from a public authority. This was also emphasized by the Federal Supreme Court in an old judgment (ATF 63 I 316 consid. 1), according to which musical culture is to be considered as being in the public interest if the entity makes sacrifices in this respect.

In a recent decision by the Federal Supreme Court (August 20, 2019, 2C_147/2019), the tax exemption was requested by a foundation whose aim was, among other things, to promote respect for animals, mainly horses, as a symbol of nature. This foundation acquired horses destined for death from their former owners so that the animals could continue their retirement. After analyzing the general conditions of the exemption, the Court considered whether this aim was truly in the general interest; it held that it was not. It thus stated (recital 5.1) that the concept of general interest should not be understood in a broad sense, which would include any activity in the service of the community and would also include all efforts to promote the economic or social interests of certain categories of the population. Public-interest goals are those that, from the perspective of the community as a whole, are particularly worth pursuing. In this case, the Court considers that even if the majority of the population does not share the view that the animal is a mere object, the acquisition of a horse is a personal choice, the consequences of which remain the primary responsibility of the owners concerned. Therefore, there is no public-interest goal in the sense of tax exemption. As said previously, the Court stated that public interest is not the sum of every community interest but interests that, from a community (as a whole) perspective, are particularly worth pursuing. This could not be construed as the addition of all personal interests. In any case, this condition should not present a specific problem for social enterprises.

3.2.2 *Disinterest*

In addition to the objective element of general interest, the notion of public utility includes a subjective element, disinterestedness. An activity is disinterested in the sense of tax law only if it serves the public interest and is based on altruism, in the sense of dedication to the community. Therefore, the notion of pure public utility presupposes not only that the activity of the legal person is carried out in the general interest but also that it is disinterested. That is, it requires a sacrifice on the part of the members of the corporation or third parties in favor of the general interest overriding their own interests. In this sense, it is required that the legal person requiring the benefit of Article 56 let. g LIFD acts in a non-profit-making capacity.

First, disinterestedness presupposes a sacrifice for the benefit of third parties in the interest of the community. This sacrifice may materialize (i) in the form of financial or work contributions made by the institution, the founder, the members of the institution's board or third parties, or (ii) through what may be termed a "collective sacrifice." That is, the activity is only carried out thanks to public or para-public subsidy or even naturally through a mixture of these different means. The sacrifice must be significant and allow the institution to have sufficient funds to achieve its statutory goals (Urech, op. cit., art. 56, LIFD N 67). In this respect, members of the institution's bodies must perform their duties on a voluntary basis, subject to reimbursement of their actual expenses, and/or in the event of activities exceeding the activity of a member of the Foundation Board/Association Committee. Hence, because they perform their duties on a voluntary basis, the managing members of the legal person are in principle subject to reimbursement of their actual expenses (Urech, op. cit. N 67 ad art. 56). This sacrifice must be of some importance in relation to the means available to the legal person. The condition of disinterestedness presupposes that an institution's activity is based on altruism.

In a judgment by a lower Court (Fribourg – RDAF 2012 II 569), the Court recognized this disinterest by stating

it should be noted on the one hand that the members of the committee and more than a hundred volunteers work free of charge. Indeed, sacrifices can be made not only in the form of cash, but also through benefits in kind. On the other hand, it is important

to note that income is also earmarked to a large extent for the provision of free events and the realization of special cultural promotion projects (at least indirect support for young talent and youth choirs, original creations, additional offers of introduction to musical culture, provision of documentation, etc.). In addition, the applicant apparently aims for the lowest possible price policy, which makes admission to paid concerts more accessible to a wide audience.

In the same vein, activity in one's own interest is deemed to exist when the aim of a foundation is to build high-quality, moderately priced housing and the personal interests of an economic group in the construction industry, which is close to it, depend on this activity, even though the latter could be a public interest (ATF 114 Ib 277).

The question of disinterestedness does not, in our view, pose a specific problem for social enterprises. Admittedly, the remuneration of the board of directors can be an obstacle as soon as tax practices require such disinterestedness. However, the 2008 Circular (p. 38) specifies that when a member of a foundation board or a committee of an association assumes tasks that exceed the ordinary activity of such group from a quantitative or qualitative viewpoint, an appropriate compensation may be paid to him. This is particularly the case if a member of a board or association committee is primarily engaged in this professional activity and is remunerated in accordance with market rates. In such a case, compensation does not preclude the notion of disinterest, since the institution would have to use the services of third parties or perform said tasks through a commercial entity. In any case, these would have to be compensated in accordance with the professional tariff applicable in the matter according to the nature of the assets to be managed or the deployed activity. Thus, the same applies to paid members of a social enterprise.

3.2.3 Unlimited circle of potential recipients

The exempt entity must not pursue its own interests, which excludes the exemption for mutual assistance institutions. Furthermore, the case law has made it clear that it is not so much the statutory purpose that is decisive but the actual use of the funds. Thus, in a recent judgment (case 2C_835/2016 of March 21, 2017, in RDAF 2018 II 437), the Supreme Court held that the exemption had rightly been withdrawn from an entity which, although having an open circle of beneficiaries in its statutes, carried out its activity – a public utility activity – exclusively in favor of members of a specific religious community. The funds paid out only went to a very limited circle of recipients, that is, institutions with the same religious affiliation. It is decisive that the restricted circle of recipients belonging to the same religion is contrary to the necessary openness.

The activity cannot generally be aimed at the entire population. However, it must be carried out for the benefit of an unspecified part of the population and is therefore aimed at an open circle of potential recipients (Urech, op. cit., art. 56 LIFD N 64). This is not the case if the circle of recipients is too narrowly limited (e.g., limited to a family circle, members of an association, or persons exercising a specific profession) (Circular AFC 1994, p. 3).

3.3 What about the prohibition of economic activities?

Once all conditions described previously are met, one should nevertheless control that the entity is not pursuing an economic goal (see especially Lideikyte Huber, 2019). This condition, which is probably the most important for our subject, that is, in relation to social enterprises

as defined previously, is the prohibition for an exempted enterprise to pursue an economic purpose. To the best of the author's knowledge, there is no direct case law in relation to social entrepreneurship under Swiss tax law that has been confronted with this condition. Nevertheless, the prohibition of a predominant economic activity has increased in some cases, notably linked to cultural activities.

Generally speaking, a profit-making purpose exists when a legal person, in a situation of real competition or economic monopoly, commits capital and labor to obtain a profit and demands a remuneration for its services similar to that normally paid in economic life. The exemption of such an entity would be contrary to the principle of economic neutrality, even if the institution were to devote itself exclusively to an exempt purpose or to allocate the entire profit to this purpose (Circular AFC 1994, p. 3; Urech, *op. cit.*, art. 56, LIFD N 74).

Thus, the criterion of market participation relates more to the services provided (outbound) (and, if applicable, invoiced) by the entity than to those it acquires (inbound). This condition is the corollary of the selflessness and sacrifice that the latter implies. However, this condition does not require that persons carrying out activities in favor of the institution should not be remunerated. An exception to this principle is the case of secondary gainful employment or when the aims of pure public utility are paramount. An economic activity (even with a certain lucrative purpose) is permissible if it remains subsidiary and of secondary importance in relation to the activity of general interest or serves to achieve the goal of public utility (Circular AFC 1994, p. 4). In this case, economic activity must be a means and not an end in itself. Hence, not every gainful activity leads to the refusal of tax exemption, provided that this activity does not constitute the final goal of the institution. Gainful activity, which remains subsidiary to altruistic activity, does not preclude an exemption based on public utility. For example, a meditation center dedicated to Buddhist practice and meditation can accommodate participants and provide courses by charging for its services, including a share of administrative costs, at cost price even if the entity is tax exempted (Supreme Court of August 17, 2012, case 2C_251/2012). The activity may either be subordinate or allow the legal entity to have the means to be allocated to the exempt purpose.

In this context, a recent case law of the Swiss Supreme Court, Supreme Court July 22, 2020, published in ATF 146 II 359, is very interesting. International School A in Geneva sought a full tax exemption, arguing that it served as a public service objective. The Supreme Court rejected its claim, stating that an exemption due to the pursuit of a public service purpose is, in principle, excluded when a legal person pursues mainly profit-making purposes, even if these simultaneously serve public-interest purposes. In any case, the exemption can only be admitted if the profit-making purposes are secondary to the main public service purpose of the legal person. Thus, an exemption, even partial, is excluded when the legal person pursues profit-making purposes that exceed a certain measure (see a previous case in ATF 131 II 1). The principle of competitive neutrality must be respected in the case of a lucrative activity of the legal person. However, this principle only applies between legal persons in comparable situations of competition.

The court responded to the appellant's argument that making a profit was a matter of medium-term survival for any public school and that it should therefore be distinguished from the goal of doing so. While it is certain that a private school must aim for minimum profitability to survive, the presence of deferred profits is an element to be taken into account in the weighting of the criteria established to determine the granting of a tax exemption. Indeed, a school run as a commercial enterprise with the aim of making a profit cannot benefit from it. Hereafter, we examine what can be derived from this case law.

4 (Deemed) obstacles for our selected social enterprise model

4.1 Obstacles

As previously mentioned, a profit-making activity occurs when a legal person, in a situation of real competition or economic monopoly, commits capital and labor to obtain a profit and demands a remuneration for its services similar to what is normally paid in economic life. The exemption of a commercial enterprise is thus contrary to the principle of economic neutrality. Even if it devotes itself exclusively to an exempt purpose or uses the entire profit for that purpose, for tax purposes, such enterprises must be treated as those that do not pursue a disinterested purpose (Urech, op. cit., N 77 ad Art. 56). There is nevertheless a commercial purpose if the natural persons behind the legal person seek gain through the latter.

In the social enterprise model described previously, several phases need to be distinguished. First, an initial research phase, which is made possible by an initial foundation. In this phase, the device to be developed or medicine is developed and researched. In this phase, there is no production or sale. Let us take the example of an X-ray machine that is designed to withstand power cuts, high temperatures, and high dust levels and must be transportable. It is already questionable whether the imperative of Swiss tax law (“Economic goals cannot in principle be considered to be in the public interest”) is respected at this early stage. The aim of the entity is to produce and sell its products, which is clearly an economic goal that, according to the law, cannot be construed as a public interest.

In fact, the law makes it clear that the *purpose of an entity* cannot be an economic one. Thus, the different phases of research and production should not change the purpose of the company. In our hypothesis, the purpose of the social enterprise is to find, develop, produce, and eventually deliver technological solutions specific to developing countries or impoverished communities. Therefore, regardless of the phase of research or development, the prohibition of economic purposes could prevent our company from benefiting from the exemption. This consequence is even truer in the following phases, especially when selling to third parties. Admittedly, this sale is made with a very small margin, allowing only basic financing for future researches. It is thus relatively clear that the activity described previously cannot benefit from a tax exemption for the purpose of pure public utility, the conditions of which are strictly described in the law.

However, why is it important that such social enterprises benefit from a tax exemption? There are several reasons. First, the entity itself is tax exempt, allowing it to lower its production costs. Indeed, this exemption covers both profit and capital taxes. Second, the exemption also allows a deduction for donations made by an entity in favor of legal persons that are exempt from tax due to their public service or public utility purposes up to a maximum of 20% of the income. In other words, as soon as the social enterprise would be exempt, all entities that finance it without any counterpart are likely to deduct this donation up to 20% of the taxable profit from their own tax. To obtain a private subsidy, in particular to finance the start of research, the exemption presents an element facilitating the search for funds for the social enterprise, since it ensures the funder a reduction in its own taxes. There is at least one final very important element in Switzerland linked to the status of tax-exempt entities. It is a type of label that indicates recognition of its utilitarian status by the state. It is a form of “State stamp” that guarantees that the entity receiving it brings some kind of special utility through its activity. If one considers these three consequences of the tax exoneration status, the last one is probably the most important.

By definition, the social enterprise does not aim to maximize its profits, and it is practically certain that it will only cover its expenses in the medium term, at least, without making large

profits. Therefore, it is not very interested in the direct effects of tax exemptions. As far as its financiers are concerned, it may certainly be interesting to be able to deduct a donation from a tax burden, but the entities that are willing to finance social enterprises are themselves generally exempt entities and therefore do not pay tax. It is therefore really this quasi-“State guarantee” effect that is most interesting for social enterprises such as in the model examined herein. This will serve to make it easier for them to find funding, and it is not uncommon for funders to require such an exemption to grant a subsidy.

In summary, given the state of the Swiss tax context, the prohibition to pursue an economic purpose expressly mentioned in the law constitutes a major obstacle to any granting of a tax exemption for the social enterprise model. As currently understood in the practice of tax administrations in Switzerland, the selected model of social enterprise would probably not be granted a tax exemption. However, this situation is regrettable, since it prevents the development of this type of social enterprise, which is of great social importance.

4.2 Are these obstacles only deemed?

However, it could be argued that the prohibition of the economic purpose should not be directly applied to some types of social enterprises. If we examine the scholarly writings and the latest case law of the Federal Court as indicated in its latest ruling on a privately owned school, it is striking that the prohibition of an economic purpose must above all avoid disrupting competition between enterprises that are in comparable situations. This can also be viewed as in line with the issue raised in the OECD report (2020), *Taxation and Philanthropy*, OECD Tax Policy Studies (ch. 2.3.3 p. 31), according to which commercial operations run by non-profit entities have an unfair advantage when competing with for-profit organizations offering the same or similar goods and services. It is clear that the prohibition of an economic purpose must prevent a company subject to tax from having to compete on the market with a competitor that is exempt from tax. If the prohibition did not exist, the exempted company would have lower production costs (by the amount of the net tax burden) than its competitors. This is also why the prohibition of economic activity in the context of tax exemption is always linked to competition. A profit-making activity can only occur when legal persons are in a situation of “real competition.” This is also the main concern of courts that have to decide cases of tax exemption in the field of culture. Exemptions for cultural purposes should not disrupt competition with non-exemptible entities operating in the entertainment field.

However, in our social enterprise hypothesis, there is, strictly speaking, no market. What is at stake in the production of a medical device for developing countries is that the market by definition is not interested in it due to lack of economically interesting outlets. Since potential customers cannot pay a market price, development and production must be carried out by a social enterprise. If there is no market, there can be no disruption of competition. More specifically, a company that produces “ordinary” medical devices is not in competition with our social enterprise because not only does it not sell the same type of products, but above all, it is also not present in the same market. Thus, assuming that there is a market, only social enterprises can, by definition, be in that market. There is therefore ultimately no disruption to free competition or to the market. An enterprise that produces ordinary medical devices is not in a comparable situation with a social enterprise that develops a medical device specific to developing countries.

It follows that the reason for which the legislator established the profit motive as a categorical prohibition of tax exemption does not allow this prohibition to be applied to our social

enterprise model. In other words, it seems that the sentence in Art. 56 DFT stating that “economic purposes cannot in principle be regarded as being in the public interest” should not prevent social enterprises considered herein from obtaining a tax exemption. As long as such enterprises do not disrupt competition between market players in similar situations, there is no need to prohibit economic purposes. The current prohibition of economic activity should therefore be substituted with a “level playing field test” in which the tax administration should control that the exemption requesting entity is interfering with legal persons in comparable competitive situations. This point seems to be compatible with the current legal text, since the law makes it clear that the prohibition is only applicable “in principle.” In this respect, the legislator did not want to prohibit all economic activity, and the substitution of the prohibition of an economic activity by a “level playing field test” allows this exception to be in line with the current law.

The current practice of tax administration can hence appear to be too restrictive compared to the *ratio legis*. This is also derived from the most recent Supreme Court’s case law, which tends to avoid disrupting competition between entities in comparable situations. However, we have sought to demonstrate that certain activities carried out by certain social enterprises do not disrupt this competition and thus should be tax privileged.

5 Conclusion

In conclusion, it must be noted that in the current Swiss tax environment, a social enterprise in the sense defined herein will face several obstacles before obtaining a tax exemption. In particular, these are the prohibition of economic purposes, as currently applied in Switzerland, which, in our view, does not take sufficient account of the hybrid nature of social enterprises. As has been proposed, if one accepts that the legal prohibition of economic purposes for tax-exempted entities ultimately serves to protect competition between similar actors, this obstacle could be removed without the need to change the law. Under this hypothesis, the social enterprise, like the model herein, which does not disrupt competition, that is not in competition with other enterprises not exempted from taxes should not be prohibited from having a “hybrid” economic purpose.

References

- Abu-Saifan, Samer, Social Entrepreneurship: Definition and Boundaries, *Technology Innovation and Management Review*, February 2012.
- Circular on Tax exemption for legal persons pursuing the aims of public service, public utility, or religious purposes, January 2008, www.steuerkonferenz.ch/downloads/merkblaetter/praxishinweise_steuerbefreiung_2008_f.pdf
- Circular on Tax exemption for legal persons pursuing public service or pure public utility purposes, 1994, www.estv.admin.ch/dam/estv/fr/dokumente/bundessteuer/kreisschreiben/2000/W95-012.pdf.download.pdf/w95-012f.pdf
- Greter, Alexander and Greter, Marco, in Martin Zweifel and Michael Beusch (eds.), *Kommentar zum Schweizerischen Steuerrecht*, ad art. 56 DBG, 3rd ed., 2017.
- Lideikyte Huber, Giedre, Activité à but lucratif d’une entité d’utilité publique exonérée d’impôt, *Expert Focus*, 2019, p. 215.
- Locher, Peter, *Kommentar zum DBG – Bundesgesetz über die direkte Bundessteuer*, II. Teil – Art. 49–101 DBG, 2004.
- Oberson, Xavier and Hull, Howard, *Switzerland in international tax law*, 4th ed., Amsterdam: IBFD Publications BV, 2011.

- Opel, Andrea, Ehrenamtlichkeit als Voraussetzung der Steuerbefreiung – ein alter Zopf? *Revue fiscale*, 2019, p. 84.
- Peter, Henry and Merkt, Benoît, Utilité publique et activité économique, *Expert Focus*, 2019, p. 209.
- Shapovalov, Valery *et al.*, Practices of Defining the Notion of Social Entrepreneurship, *International Journal of Innovative Technology and Exploring Engineering (IJITEE)*, Vol. 9, No. 1, November 2019.
- Urech, Nicolas and Noël, Aubry Girardin (eds.), *Commentaire Romand de la loi fédérale sur l'impôt direct*, 2nd ed., ad art. 56 LIFD Bâle: Helbing Lichtenhahn, 2017.
- Vogelsang, Marc, GEMEINNUETZIGE ORGANISATIONEN IM MEHRWERTSTEUERRECHT, *ExpertFocus* 10/21 p. 501.
- Zahra, Shaker A. *et al.*, Globalization of Social Entrepreneurship Opportunities, *Strategic Entrepreneurship Review*, June 2008.