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Italy

Operating Concessions as a Factor in the Growth of Non-Profit Concerns and a tool for Reform of the Welfare State

Summary:

1. Models of Welfare State: the Italian choice.
2. Operating concessions from the standpoint of government and of non-profit concerns.
3. When is a concern genuinely non-profit? The insufficiency of the non-distribution constraint.

1. Models of Welfare State: the Italian choice

When a State grounds its economic and social policy and action on the principles of the Welfare State, it necessarily does three things.

- a. First, it determines which goods and services (health care, education, cultural heritage, etc.) should be supplied, for reasons of solidarity and social justice, to all citizens, regardless of their economic means.
- b. Second, it lays down the rules by which this must be accomplished: for instance, universally free of charge, participation by the consumer in the costs of production (fixed or variable charges depending on objective needs such as the nature of the service or subjective characteristics such as state of health, individual capabilities, income and the like).
- c. Third, it determines how the cost is to be shared among all the members of the community via the government budget. As supplying certain goods and services entails costs that are sustained only in part, if at all, by their beneficiaries, these costs are covered by budgetary allocations, i.e. by the entire community. This burden, in turn, is distributed among the members of the community according to the principals governing the public finances and tax policy and the rules followed in financing public costs in general (the mix of tax and non-tax revenues, of direct and indirect taxes, of proportional and progressive income taxes, and so on).

These decisions rehearse the essence of the Welfare State: the State takes the responsibility for economic and social policy and makes sure of satisfaction of needs that the market, left to itself, cannot serve without violating the sense of justice and social solidarity that inspire the community. To achieve this, the State need only set the «rules of the game»; it is enough, in other words, for it to act as regulator.

Sometimes, though, the State also acts as producer; that is, it directly organizes the factors of production and takes on management and operational responsibilities, in what can be dubbed «self-production».

It is the variable combination of the two roles that generates the different models of Welfare State: some more essential and streamlined, others involving a heavier burden of tasks and responsibilities for government.

In Italy, the State has taken on both roles, thus greatly extending its functions, concentrating in public hands responsibility for the supply of a multitude of services, such as health care, education, compulsory social security, the cultural and environmental heritage, and so forth.

An obvious consequence is that the State is often in a dominant position in the supply of certain goods and services. It operates, that is, in monopoly or near-monopoly conditions. In such circumstances the scope for non-profit initiatives, which generally come in the same sectors in which the Welfare State acts, is cramped indeed.

In principle, no absolute preference for one model over another can be assigned. Depending on time, place, and circumstance, one solution or another may prove preferable.

In Italy, the assignment to the State of the role of both regulator and producer is showing its weaknesses, and it is more and more widely recognized that the State can and must diminish its involvement in the production side and concentrate on the essential regulatory functions of planning, guidance and control.

It being premised that it remains in the general interest that some goods and services be provided to all citizens, and in particular to the poor and disadvantaged, according to rules and standards laid down by government and at public expense, their production may nonetheless be assigned to other agents: in our case non-profit concerns, which often operate more efficiently and produce better services than direct public management.

This is not the place for an examination of why in Italy, in our historical period, it has often though not always been the case that direct public provision of services has been worse than that of non-profit concerns. Rather, we must ask how it is possible, in the general interest, to modify the division of production responsibilities between government and the non-profit sector in order to better serve the needs of individuals and thereby the welfare of the community.

In principle, two different approaches are possible.

- a. Retain the present public production role and give non-profit concerns the task of meeting only new, emerging needs. Traditional needs would still be seen to by the State, in the dual role of regulator and producer; for new ones, the State would act solely as regulator and non-profit concerns as producers.
- b. Bring about the conditions in which the State, while keeping its full regulatory powers, can curtail its role as provider, including the areas in which it now directly supplies services, and turn responsibilities over to non-profit concerns under suitable rules and safeguards, which need to be established.

Obviously, under approach (a) the increase in the incidence of production by the non-profit sector is a function of the rate of growth of new needs compared with those now serviced directly by the State. As the State currently operates virtually everywhere and virtually monopolizes supply in many areas, it is easy to foresee that the change in the balance will be slow, even if there are imperious new needs.

Under approach (b) the expansion of the non-profit sector relative to the public is potentially faster, because it depends only on the proportion of production responsibilities that the authorities decide to transfer.

The question is how, in practice, one can implement plan (b), rapidly reducing the public role as producer. The best instrument is the operating concession, a method widely used in other branches of the economy and typically entrusting the operation of some services or the production of some goods to private businesses^[1].

Let us examine, then, how operating concessions can be useful in achieving a new division of the responsibilities for the production of Welfare State goods and services.

2. Operating Concessions from the Standpoint of Government and of Non-Profit Concerns

For obvious reasons the switch from direct public production to «indirect» production of certain goods and services must be gradual; all the more so given the initial situation of widespread self-production in monopoly or near-monopoly conditions.

The State might consider the concession of activities now performed directly to organizations offering sufficient guarantees, such as the non-profit concerns.

For instance, it could transfer the operation of a museum, an archeological site, or a hospital to a non-profit concern that has demonstrated its capacity to perform satisfactorily, with prior agreement on minimum standards of quality and efficiency; if the concessionary failed to meet the standards it would be required to make up the difference out of its own resources, not at the expense of the public purse.

For the community, such a process begins to be economically worthwhile when the concessionary produces more or better goods or services at the same cost of direct public operation or else when, for equal quantity and quality of output, it sustains lower costs.

The State would pay a predetermined amount to the concessionary for the service, taking account of the agreed standards of quality and efficiency. As a result, the cost of production would still be defrayed by the State; the modalities of payment would also remain unchanged, as the concession to non-profit concerns would not, in and of itself, entail modification of the way in which the State covers the costs of providing the goods or services.

Other things being equal, the gain to the community would consist in an improvement in efficiency and efficacy in service provision. Naturally, the concession might also perform «worse» than direct public provision, but in this case, as noted, the concessionary would have to make up the difference at no extra cost to the State. Hence the need to select non-profit concessionaries that are reliable in economic terms, capable of discharging their commitments and coping, if necessary, with the adverse effects of their own inefficiencies.

In this light one can grasp the full import of some relatively recent rules changes which, though addressed to other entities and varying in legal rank and content, constitute significant premises in law for the introduction of operating concessions to the non-profit sector. And it was precisely for this purpose that they were made.

The tax treatment of non-profit concerns was reformed by Legislative Decree 460/1997 ^[2], largely enacting the conclusions of the Zamagni Committee. The legislation introduces, effective 1 January 1998, a new principle governing economic relations between non-commercial entities, as the Decree calls non-profit organizations in general, and government.

Article 2(1) amends the Consolidated Income Tax Code (Law 917/1986), by inserting paragraph 2-bis into Article 108:

"In any case the following items do not form part of the income of non-commercial concerns referred to in Article 87 (1c):

- a) ... omissis ...;
- b) contributions from general government bodies to the aforesaid concerns for the performance under convention or as an accredited body pursuant to Legislative Decree 502 of 30 December 1992, Article 8(7), supplanted by Legislative Decree 517 of 7 December 1993, Article 9 (1g), of activities for social purposes performed in conformity with the institutional purposes of the entities."

This clause is not simply one of the many tax breaks for non-profit concerns scattered through the tax code. It is much more. It truly lays the foundation for the redistribution of duties between the State and the non-profit sector. The purpose is to give incentives to non-commercial entities to take over the production of goods and services now produced directly by public agencies, relieving the latter of the heavy burden of direct economic operation.

Note that this innovation in no way questions the principle underlying the Welfare State, that in the name of solidarity and justice the community has elected to provide to all citizens, regardless of their economic resources, certain goods and services. For it is still the State that determines which goods and services shall be supplied, sets the rules under which this

must take place, and decides the criteria for sharing the cost among all members of the community, via the public budget.

The law deliberately restricts this principle to the production or supply of goods and services. It is designed to galvanize a largely soporific system in order to achieve, in the general interest, greater efficiency, which can only be attained insofar as private non-commercial concerns produce a better combination of productive factors than the State.

To date, the full potential of the principle has not been grasped. But allowance must be made for the fact that it has only been in force for a few months. It is very broad indeed in scope, in that it excludes from non-commercial concerns' income contributions:

- a. from general government; this term is not limited to central government departments and agencies but extends to all State bodies, both central and local, and to non-state public bodies such as local governments and public bodies in general [3];
- b. for services provided under convention or provided by accredited bodies (typical of the health care system) for social purposes performed in conformity with the institutional purposes of the entities. The performance of activities under convention is the standard way of implementing operating concessions, as these concessions are governed by conventions.

The term "contributions" itself, as used in the law, must be taken in its broadest sense, referring not just to transfers (the charges on the public budget with no corresponding service on the part of the beneficiary) but also covers compensation for services [4].

Even these brief observations should suffice to underscore the enormous import of the new law and its still unrealized potential.

Another act comparable in intent if inferior in legal rank, nature, and persons covered is the «Dini» directive of November 1994, governing some aspects of what are commonly called "banking foundations[5]."

Article 5(2) of the directive specifies that "The institutions can achieve their statutory purposes also by means of performance of public services under concession."

When the directive was issued, some people were much surprised. Until very shortly before, the discussion on the foundations, their new non-profit role after separation from the banking concerns proper, and how to realize it had turned generally on whether the foundations should support other institutions' initiatives, as they had always done in the past, or employ their resources in initiatives of their own, taking direct responsibility (acting themselves) or indirect (through affiliates, presumably also non-profit organizations, that they controlled).

Just months before the issuance of the Dini directive, the discussion had revived, after a period of being overlooked in the general concentration on the splitting-off from the banks.

In October 1993 Italian association of savings banks held a conference on the topic: "Ruolo e natura degli enti conferenti: problemi e prospettive" (The role and the nature of banking foundations: problems and prospects).

Here, a set of proposals decisively broadened the horizons of the debate.

One of the ways in which these foundations could achieve their purposes suggested by the conference was, in fact, for them to take over, under concession, some services or activities operated directly by government bodies — a third way besides funding the initiatives of others (old or new) or undertaking action themselves [6].

Within a few months the directive adopted this proposal, explicitly authorizing the foundations to operate under concession and creating the premise for a redivision of production between public bodies and this significant group of non-profit entities, with their substantial economic resources.

Authorization to perform public services as concessionaries does not extend to any and every type of activity; it is restricted to the sectors in which the institutions are permitted to operate [7], thus excluding banking foundations, for instance, from being concessionaries for highway or telecommunications services. The directive ties the possibility of being a concessionary for public services irrevocably to the statutory purposes of the institutions ("The institutions can achieve their statutory purposes also by means of ...").

Here again, the intention is clear: expressly authorizing these foundations to act as concessionaries establishes the conditions whereby this important class of non-profit institutions can take over some public service provisions functions, possibly allying with other, specifically qualified non-profit concerns depending on the nature of the initiative being carried out (sector, location, duration, etc.).

3. When is a Concern Genuinely Non-Profit? The Insufficiency of the Non-Distribution Constraint

Students of non-profit concerns are often asked to respond to a seemingly banal question: when is it that a concern can be called genuinely non-profit? What are the economic requirements? And when, consequently, can the authorities be relatively sure that they are dealing with truly worthy concerns? For these concerns, though moved by non-economic purposes, inevitably have to do with the procurement, conservation, transformation, and consumption of wealth [8].

A number of observers have commented on the limitations of the residual category of «non-profit» concerns, conventionally used to distinguish them from for-profit concerns, so called enterprises, firms or equivalent [9].

Let us recall that enterprises are only created and kept in existence insofar as there is the prospect of some economic gain for those who residually supply the productive factors, hence assume the general economic risk and for that reason take control.

Ordinarily, such economic gain takes the form of a surplus, an excess of revenues over costs; this is typical of capitalistic firms, in which the residual position is held by equity capital. In this case the economic gain can be considered appropriate to the extent to which the enterprise's surplus, taking risk into account, is at least equal to the remuneration that could have been earned by an alternative investment of the capital.

The prospect of economic gain that defines every enterprise may also be implicit, however, as is the case of some cooperatives. For instance, the growers who supply their crop of grapes or olives to a wine or olive-oil producing and marketing cooperative, of which they are members, do so because they expect to earn more than by selling their crop directly on the market. Otherwise, they would not deliver their crop and take payment depending on the outcome of the coop's production and sales procedures. Similarly, members of building cooperatives expect a specific economic gain: to purchase a certain type of dwelling at a lower price than they would have to pay on the open market. Without this prospect, they would hardly join.

In both cases, the motive for the creation and maintenance of the enterprise continues to be economic gain. The nature of the gain is different, however. It no longer consists in the explicit surplus earned by the capitalistically organized company but in an implicit economic gain for those who assume the risk. In the case of a farmers' coop, the risk lies in the contractual provision that payment for one's raw product depends on the proceeds from sale of the finished product, with no assurance that such remuneration will be greater than would have accrued from direct sale of the raw material on the market. In the building coop, the risk lies in the prior commitment to defray the cost of construction without assurance that in the end one will actually spend less than by simply purchasing one's home in the real estate market.

In all forms of enterprise, no matter how the economic gain materializes, the drive for economic behaviour and economically viable decisions is fueled by the conflict of interest between those who assume the general economic risk, confer productive factors that are remunerated on a residual basis, and therefore control the management, on the one hand, and on the other those who provide the enterprise with the productive factors required under contract. Other things being equal, the better the results for the residual productive factors, the less the costs for remuneration of contractual productive factors. In competitive markets, the spur to cost-cutting is especially strong, because only by containing them as strictly as the competition can the residual productive factors be suitably remunerated. In a competitive market, in fact, in contrast to monopoly conditions, economic viability cannot be attained by action on selling prices.

In enterprises, in short, the drive for economic viability naturally leads to cost containment. In competitive markets, it can be assumed that productive factors under contract are secured on market terms.

So much for the essential characteristics of enterprise. But we still do not know when we are dealing with a genuinely non-profit concern.

If enterprises are defined by the profit motive, one naturally presumes that non-profit concerns are created and kept in being essentially for non-economic motives, certainly not to procure economic gain for someone. Such gains are perfectly legitimate, of course, for profit-making concerns but are foreign to the logic of the non-profit.

However, a non-economic motive, tantamount to the intention not to reap economic gain from the activity of the non-profit concern, is certainly not sufficient to define it. Intention alone is self-evidently insufficient, both because there is always the possibility of deliberate violation of the original intent and because even in the best of cases the results may not correspond to intentions.

In short, we need objective limits, going beyond the psychological and subjective realm of intentions. This is the background to the non-distribution constraint as the distinctive trait of the non-profit concern: that is, a ban enshrined in the organization's statutes on distributing profits or operating surplus [10] either during the life of the concern or on upon its dissolution, for whatever reason. Presumably it was felt that as the capitalistic enterprise is characterized by economic gain in the form of a surplus that is the property of those entitled to it and can be distributed immediately or set aside for future distribution, banning any such distribution at any time to anyone [11] would eradicate the economic motive. That is, the non-distribution constraint was deemed sufficient to preclude economic gains for third parties, and this in turn was felt to warrant talking objectively of another class of concerns, the non-profit ones.

And in fact if this constraint by itself could preclude economic gain to third parties, it would be at once the necessary and the sufficient condition for objectively discriminating between for-profit and non-profit concerns.

But as we shall see, the constraint alone is not enough to do the job.

4. The Object of the Non-Distribution Constraint

Ordinarily, the constraint is on distribution of the profit or operating surplus that the activity generates.

When a non-contractual productive factor (usually capital) is conferred upon a concern, one should ask whether the constraint applies not only to the surplus but also to the factor as such. That is, does the ban extend to the distribution (or, if you prefer, the restitution) of the original capital? An instance is the «own» capital of concerns controlled by foundations: can this equity be returned to the founders or not?

From the strictly economic standpoint, ignoring the countless non-economic reasons for doing so (ethical, social, religious, moral, solidarity, etc.), someone who today confers upon a concern capital that is not remunerated but simply returned to him in the future certainly makes no profit on the transaction. Even assuming zero inflation for the whole period, non-remuneration obviously entails an economic sacrifice, the forgoing of the alternative yield. Still ignoring the non-economic side, in case of inflation the sacrifice of forgone earnings is compounded by the loss of purchasing power.

Accordingly, having ascertained the impossibility of such an operation's producing any sort of economic gain (indeed, it results in a loss), there is no reason in principle to make the ban on the restitution of capital a *sine qua non* for the non-profit concern.

As a consequence, the non-distribution constraint can perfectly well be limited to profits or operating surpluses, and not

necessarily cover productive factors conferred upon the concern on a non-contractual basis.

Second, it must be considered that the constraint focuses on the relationship between the concern and third parties but governs only one particular aspect of the relationship, the distributability of the surplus generated (Table A). The constraint has no bearing whatever on relations between third parties whose object is the concern (Table B).

This is the case of non-profit concerns control of which can be transferred, either because they are incorporated, in accord with the principle of freedom of choice concerning corporate form (or, if you prefer, the prevalence of substance over form), so that control can be transferred in the usual way, or else because "atypical" transfers are always possible [12].

In either case, despite the non-distribution constraint, the transfer could be accompanied by some compensation, i.e. economic gain, for the person giving up control. The gain would not involve direct relations between the concern and third parties, which are the object of the constraint, but two third parties; yet the transaction would involve the concern.

However, given the constraint, it can be observed that the possible gains from transfers of control (no matter whether regular or atypical) would be very modest, and if the constraint is very strict, near zero. To be sure, it is hard to imagine what economic advantage could stem from taking control of a concern that can never distribute surpluses to anyone and even return productive factors conferred non-contractually. The advantage should be practically nil — if the only source of economic gain actually lay in these factors. Sometimes, however, the economic gain originates elsewhere, indirectly, through the fact of control, though no direct profit can be made.

A well-known case in point, for Italy, is provided by professional sporting companies after the reform law of 1981 [13]. In order to sign contracts with professional athletes, they had to take the form of a company limited by shares or a limited liability partnership. The law also required the reinvestment of all profits for the exclusive pursuit of sporting activity, and if the company was liquidated the owners of shares or capital parts could not receive more than their face value, any excess value being credited to the Italian National Olympic Committee. Finally, their acts of incorporation could subject the sale of shares or capital parts to special conditions.

Despite the non-distribution constraint (on profits only), and the limitation of reimbursement in case of liquidation to the amount of capital paid in, at most, everyone knows that sports corporations, most notably soccer teams, have often changed hands in return for very substantial sums of money, at handsome capital gains for those yielding control. Ruling out non-economic motives and irrational behavior on the part of the buyers — a reasonable assumption, given the frequency of such sales — the basis of the gain can only lie in indirect economic advantages deriving from control of the team.

This confirms that the non-distribution constraint is a necessary but not sufficient condition for preventing third parties from obtaining direct or indirect economic gain from a concern, because by nature the constraint cannot impinge upon relations between different third parties (Table B). Nor is that all. Even in relations between the concern itself and third parties (Table A), the constraint binds only profits or operating surpluses, ignoring the other economic advantages that may be derived from control of the concern.

5. The Non-Distribution Constraint and Indirect Distribution of Economic Gains

The non-distribution constraint applies to profits or operating surpluses already fixed in amount by a set of accounting rules. That is to say, it applies to the allocation of the final surplus, neglecting what happens previously, i.e. how the surplus is determined during operations.

This neglect of the process, whereby the surplus is generated, is based on the assumption that during the operative phase, from the purchase of productive factors to the sale of the product, third parties dealing with the concern cannot obtain (greater) economic gain than they would otherwise have been able to. And if this were effectively so, the constraint would be sufficient to prevent third parties from profiting indirectly.

Actually, however, economic gains can be allocated to third parties (either contractual suppliers of productive factors or users of the product) before the surplus emerges by acting on the components that determine it. That is, the concern can be so managed as to reduce or eliminate the eventual surplus, totally voiding the constraint of meaning.

As profits or operating surpluses represent the excess between the positive and negative components of the profit and loss statement (i.e., between revenues and costs), the question has two complementary facets.

The negative or cost components of gain distribution comprise indirect gains to third parties from dealings with the enterprise when the factors purchased (supplies, instrumental goods, services, credit, labor, etc.) are contracted for at higher than current market prices. This, for no reason, gives an evident economic advantage to the supplier; and obviously in its absence the concerns' final profit or operating surplus would be larger.

Theoretically this problem could be dealt with by prohibiting the purchase of supplies at above the market price. It is not always easy to check compliance in practice, but we should not refrain from introducing the principle for this reason. The difficulties can be overcome with experience, applying the rule intelligently and with economic wisdom.

Note that, in principle, purchases of goods or supplies above market prices should always be prohibited, whether the persons involved are within the orbit of the concern and might be tempted to turn its activities to their own advantage (founders, directors, members, associates, sustainers, etc.) or outsiders who cannot wield influence (suppliers, customers, etc.). From the economic standpoint there is never a good reason for such purchases.

To be sure, the question is most pressing for persons who are within the immediate «orbit» of the concern and may have been led to form it or keep it in being for the sake of indirect gains for themselves, relatives, friends, subsidiary and associated businesses, and the like. Devices for extracting such benefits could include borrowing at exorbitant rates, paying outlandish salaries to "friends," or purchasing goods or services at higher than market prices from suppliers belonging to the same group that controls the non-profit concern. In any case, the ban on overpriced purchases should extend to all potential suppliers, regardless of possible conflicts of interest or influence on the non-profit concern.

This is the direction taken by several recent modifications of the tax treatment of a sub-category of non-commercial concerns designated "socially useful non-profit organizations" [14]. In Italy these are known by their acronym, ONLUS.

The organizations are the cutting edge of non-commercial concern, and their tax treatment — in return for satisfaction of stringent requirements — is the most liberal found in the Italian tax system.

In order to prevent these organizations from giving out economic advantages before the formal surplus is determined, the negative or cost components of the net operating surplus are subjected to restrictions:

1. "d) prohibition on distribution, including indirect distribution, of profits or operating surpluses as well as funds, reserves or capital ..." [15];
2. "6. In any case, the following shall be deemed to constitute indirect distribution of profits or operating surplus:
 - a. ... omissis ...;
 - b. the purchase of goods or services for amounts which, in the absence of sound economic reasons, are above their normal value;
 - c. the payment to members of administrative or control bodies of individual yearly emoluments higher than the maximum laid down by Presidential Decree 645 of 10 October 1994 and by Decree Law 239 of 21 June 1995, ratified as Law 336 of 3 August 1995, with subsequent amendments, for the chairman of the boards of auditors of companies limited by shares;
 - d. the payment to persons other than banks and authorized financial intermediaries of interest on any kind of loan that is more than four percentage points above the official discount rate;
 - e. the payment to employees of wages or salaries that are 20 percent higher than those stipulated in the national, industry-wide collective bargaining agreement for their job categories." [16].

Thus the law not only opts for the broadest acceptance of the non-distribution constraint (i.e., covering funds, reserves and capital) but also prohibits "indirect distribution" of the surplus, which it then proceeds to define in detail.

Paragraph 6(b) lays down the general principle: indirect distribution, which is prohibited, is defined as the purchase of goods or services at prices higher than "normal," this being a typical term in tax law that means, quite simply, market prices [17].

Paragraph 6(c), (d) and (e) refers to the more "delicate" — and more commonly practiced — instances of acquisition of goods and services involving indirect distribution of the surplus. These clauses place specific limits on (a) compensation to members of boards of directors and auditors, (b) the cost of loans from persons other than banks and other authorized intermediaries, and (c) employee compensation.

The positive or revenue components of surplus distribution are treated somewhat differently.

Of course, it must be recognized that an economic gain is conferred on third parties if the concern supplies goods or services free of charge or at less than market prices, where these exist.

Yet it is precisely the defining activity of many non-profit concerns to provide goods or services free or significantly below cost, the cost than being covered wholly or partly by private donations and public grants.

It therefore makes no sense to conceive of a rule that is the exact counterpart to those governing the negative components, namely to prohibit free or below-cost transfers of goods or services. Such a provision would attack the very nature of many non-profit concerns.

One might conclude that nothing need be said concerning the conferral of economic gain through the revenue side of the profit and loss statement. Yet some precautionary measures are in order here too, at least with respect to persons within the «orbit» of the concern who may influence its management.

One question is whether indiscriminate access to the concerns' goods and services should be allowed solely because one is founder, director, partner, associate, sustainer, and so on. There would not seem to be much reason to answer in the affirmative. Especially in the case of valuable goods and services, it is too easy to "acquire" a personal right of access to the organization's output even without any of the eligibility requirements imposed on other users.

At the other extreme, however, can one advocate simply disallowing access to the concerns' output for all those in positions of authority? Again, the answer has to be negative. Why should the concerns' employees, directors, partners, associates, or sustainers who have the same eligibility qualifications as outsiders be denied access to its goods or services?

The solution must be located between the two extremes.

For instance, indirect distribution of profits or operating surplus could be defined to include access to output on the part of persons in the orbit of the concern at more advantageous terms or under less restrictive conditions than those applying to outsiders. This would sharply restrict access to output on the part of persons holding certain positions but allow them to benefit where they satisfy the ordinary eligibility requirements.

In short, no advantage should accrue to persons involved in the concern, but neither should they be penalized for the fact that they might be tempted to exploit their position for personal gain.

This is the line taken by recent legislation governing socially useful non-profit organizations. The positive, or revenue-side, components of potential indirect distribution of economic gains are defined as follows:

"6. In any case, the following shall be deemed to constitute indirect distribution of profits or operating surplus: a) transfers of goods or provision of services to partners, associates or members, to founders, to members of administrative and control bodies, to persons that operate within the organization in any capacity or that form part thereof, to persons making donations to the organization, their relatives up to and including the third degree of kinship, and any companies directly or indirectly controlled by them or associated with them, that are effected on more favourable terms by reason of their status. ... omissis ..." [18].

All in all, these legislative reforms are a step in the right direction. Though reflecting the context in which they originated, the new provisions are the first attempt, to my knowledge, at a more advanced definition of the objective economic conditions that must obtain for a concern to be considered genuinely non-profit. This approach is a way out of the quicksand of judgment by intention, in which psychological considerations, while serving to denote certain characteristics of the non-profit concern, display evident and unacceptable shortcomings.

6. The Non-Distribution Constraint and the Reinvestment Obligation

In some cases, instead of laying down the conventional non-distribution constraint, it is preferred to impose an obligation to reinvest any surplus obtained. This attains the same result, but also something more.

The result is the same, in that requiring the surplus to be reinvested implicitly prevents it from being distributed. At the same time something more is obtained: a positive obligation to act rather a negative injunction, a prohibition.

All things considered, this is the better choice: though it needs to be properly modulated to avoid unwanted and economically irrational effects, this approach has solid economic foundations. The non-distribution constraint alone, in fact, leaves the concern theoretically free to accumulate surpluses without end, paying no attention to their use, i.e. whether or not the funds are employed for the statutory purposes.

On the other hand, it is plain that if the reinvestment requirement were formulated rigidly — say, as an injunction for immediate reinvestment, year by year, for the pursuit of statutory purposes — it would prevent the accumulation of resources for expenditure in future years when difficulties are foreseen; that is, it would preclude the countercyclical compensation between «fat» and «lean» years without which activity may undergo abrupt declines.

In conclusion, as long as it is formulated in such a way as not to burden the management of non-profit concerns with overrigid restrictions, the reinvestment requirement is a welcome innovation, one that attains the same purposes as the non-distribution constraint while also allowing for significant factors that elude the latter.

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Notes

[1] See Eugenio Pinto, *L'economia delle imprese in regime di concessione*, Giuffrè, Milano 1996, p. 31 ff.

[2] The Decree is published in "Supplemento Ordinario" 1/L to Gazzetta Ufficiale della Repubblica Italiana, No. 1, 2 January 1998.

[3] For definitions of general government, see the national and Community systems of accounts. Regulation 2223/96/EC, 25 June 1996, on the European System of Accounts (national and regional) reads as follows: «*The sector general government (S. 13) includes all institutional units which are other non-market producers whose output is intended for individual and collective consumption, and mainly financed by compulsory payments made by units belonging to other sectors and/or all institutional units principally engaged in the redistribution of national income and wealth.*» (Point 2.68). Like all Community regulations (and unlike directives), this lays down rules directly applicable and effective within the Member States of the European Union. The Italian rules for the public accounts and the national economic accounts follow this approach and distinguish, gradually widening the field of vision, between the State, the state sector, the enlarged public sector and - the point that interests us here - general government (Law 468 of 5 August 1978 with its subsequent amendments on the State budget and the public accounts).

[4] On this point, see application circular 124 of 12 May 1998, in which the Ministry of Finance's Revenue Department specifies: «*As to the nature of the contributions exempted, note that the rule, with its general reference to contributions from general government units for the performance under convention or as an accredited body of activities for social purposes performed in conformity with the institutional purposes of the entities, makes no distinction between unrequited transfers and contributions that are in the nature of compensation. Hence it is to be concluded that the exemption also covers contributions that partake of the nature of compensation.*»

[5] Directive of the Minister of the Treasury of 18 November 1994, published in Gazzetta Ufficiale della Repubblica Italiana,

"Serie Generale" No. 273, 22 November 1994.

[6] See, for one, Eugenio Pinto, *"Gli enti conferenti: aspetti economici e di bilancio"*, II Risparmio, Vol. XLII, No. 2, March-April 1994. The article is also available in Internet in the section "Documenti" at: <http://www.luiss.it/facolta/economia/pinto>.

[7] The areas in which the banking foundations can operate largely coincide with those of the Welfare State: health, education, art, scientific research, protection of disadvantaged social groups, etc. See Legislative Decree 356 of 20 November 1990, Title III (Public granting institutions), adopted pursuant to the "Amato Law", i.e. Law 218 of 30 July 1990; see also the statutes of the banking foundations.

[8] See Umberto Bertini, "Relazione di presentazione", XVIII Convegno Annuale dell'Accademia Italiana di Economia Aziendale, Clueb, Bologna, 1996, p. 1 ff.: *"The fact that these concerns' purposes are not economic but social and humanitarian does not, in my view, affect their operations: the economic viability of a concern is independent of its institutional purposes. Rather it depends on the concerns's model of governance, its organization, and its strategy; in a word, on the validity of its system of management."*

[9] A representative instance is Pellegrino Capaldo, "Le aziende non-profit tra Stato e mercato", in XVIII Convegno Annuale dell'Accademia Italiana di Economia Aziendale, Clueb, Bologna, 1996, p. 13 ff.: *"The non-profit concerns to which I refer, then, are private concerns acting within the sphere of individual liberty. The aspects to examine are essentially two. The first regards the technical and economic basis of these concerns, the conditions on which durable existence depends, and perhaps the circumstances in which, as a means of production, they may prove to be more effective than State concerns both in the interest of individuals and in the general interest. The second facet involves possible government action to foster the spread of non-profit concerns in the likely case that the foregoing analysis concludes that they can play a major role in the balanced growth and progress of the community."*

Proper analysis begins by moving from a negative to a positive definition of the subject. It is easy to imagine that within the non-profit sector there are groups of concerns with different aims and different conditions of economic viability. That is, to gain a thorough understanding of these concerns it is not enough to grasp the mere fact, important as it is, of not being profit-making. One must go further to locate the significant elements of differentiation within the sector, hence to identify different types of non-profit concern. To this end, it will be helpful to step back and rethink the classification of concerns into for-profit and non-profit and in particular to re-examine the notion of profit. "

[10] For the distinction between profit and operating surplus, see Eugenio Pinto, "I lavori della commissione "Zamagni" e la nuova disciplina tributaria delle aziende non-profit", in Atti dei convegni e seminari del primo semestre 1997 organizzati dall'Ordine di Roma dei dottori commercialisti, Rome 1997. The article is also available in Internet, in the section "Documenti" at <http://www.luiss.it/facolta/economia/pinto>.

[11] Not only to those supplying non-contractual productive factors, therefore, but also to directors, members, etc.

[12] For instance, consider a non-profit concern controlled by a foundation which itself is controlled by given persons thanks to the power to appoint a majority of the members of the foundation's board. In this case, transferring the power of appointment through changes in the by-laws would be tantamount to an "atypical" transfer of control.

[13] Law 91 of 23 March 1981, published in Gazzetta Ufficiale della Repubblica Italiana, No. 86, 27 March 1981.

[14] Legislative Decree 460 of 4 December 1997, Section II, Articles 10-29.

[15] Legislative Decree 460 of 4 December 1997, Article 10 (1d).

[16] Legislative Decree 460/1997, Article 10(6).

[17] See Consolidated Income Tax Code, Presidential Decree 917 of 22 December 1986, Article 9 (3).

[18] Legislative Decree 460/1997, Article 10(6).