ENTERPRISE FOUNDATION LAW
IN A COMPARATIVE PERSPECTIVE

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FOREWORD

An enterprise foundation is a nonprofit organization that serves to own and control a conventional for-profit business corporation that produces goods and services for the general market. This ownership structure has been common in the nations of northern Europe for well over a century and was similarly common in the United States until 1969, when controversial changes in U.S. tax law rendered enterprise foundations no longer viable.

Despite (or because of) their unconventional structure and economic success, enterprise foundations (EFs) and the subsidiary operating companies (SOCs) that they control, were long neglected by scholars in law and social sciences. This situation changed profoundly when Professor Steen Thomsen of the Copenhagen Business School began to study these anomalous firms and ultimately persuaded a number of colleagues and students (including, importantly, scholars from other countries) to join him in this project. Although Thomsen has previously published important articles on the subject, written alone or with others, this volume – co-edited by Professor Anne Sanders of the University of Bielefeld – is the first collective fruit of the broader international scholarly coalition that Thomsen has assembled and guided. As is appropriate, the book is essentially a mapping project, setting out the central facts and themes to be explored.

The book concentrates on the legal framework for EFs and leaves it largely to future scholarship to probe economic, political and social forces that might lead to the formation of EFs. Neverthless, it presents sufficient facts to support some broad conjectures that might be fruitful foci for future research.

It is apparent from the statistics presented in the chapters that follow that a disproportionately large number of EFs are located in northwestern Europe in countries that are small, prosperous and technically sophisticated. Why should this be? The patterns described in this book might be taken as potential support for several broad conjectures which are not mutually exclusive.

One of those conjectures is that, by placing a nonprofit organization in control of a for-profit firm, it may be possible to get the best attributes of

each form: the competitive striving for efficiency of a profit-seeking firm whose success is measured in simple monetary terms, and the reluctance to exploit opportunistically the incompleteness of markets that arguably characterizes nonprofit entities. This is, however, a complex subject which will require a substantial commitment of time and sophisticated effort to understand. In this short Foreword, therefore, I will focus on a more familiar and simpler type of conjecture, which is that a substantial portion of the support for EFs has its roots in economic nationalism – though this is not to say that it is injurious to the societies involved.

In this regard, it is helpful to begin by looking at the types of special benefits that, in a hospitable legal regime, seem commonly to be available to persons (particularly founders and their families) who pass control of their firm to an EF. Very roughly described, those benefits seem generally to include one or more of the following:

> *Tax Benefits.* The SOC's founder and his or her family may be relieved of a variety of transfer taxes, including gift and inheritance taxes on the value of the controlling shares that the founder transfers to the EF.
>
> *Profits Without Ownership*. A founder may be able to reserve for his or her descendants a share in the future profits of the SOC even though they own no shares in the SOC.
>
> *Non-Pecuniary Private Benefits of Control.* Even if the founder and his or her family retain no rights to a share in the profits of the SOC, the founder may be able to exercise effective control over the SOC by virtue of the right to appoint its initial board, in the reasonable expectation that the persons he or she appoints will manage the firm as he or she would wish, as will the succeeding self-appointing boards. The engagement, status, and influence (both social and political) that the founder thus retains may in itself be an enormous benefit for him or her.

What, beyond the political influence of individual founders, could be the state's motivation for granting such benefits? The most obvious answer is that they serve as incentives, to the firm and its founder, for keeping the SOC located in its country of origin. Highly successful firms that get their start in a small country are often bought by foreign firms from larger and wealthier countries. This may be perceived as an indignity by the smaller country's population and may have negative material consequences for that country as well, including loss of tax revenue, loss of jobs, and loss of support for improving the nation's physical infrastructure and, perhaps more important, its intellectual infrastructure, such as apprenticeship programs and universities.

In these circumstances, ownership of a firm by an EF may have the important result of keeping that firm registered and headquartered, and its operations located, indefinitely in its country of origin, without the compulsion of nationalization or other heavy-handed forms of regulation.

In the US the potential for economic protectionism through encouragement of foundation ownership, though once strong, has largely been eliminated, presumably because the nation's economy is now sufficiently large, diversified and productive to provide sufficient economic and social benefits to successful startups to induce them to remain within the country.

The US tax legislation of 1969, which brought the demise of nearly all of the country's EFs, imposed an upper limit of 20% on the fraction of any company's stock that could be held by a nonprofit foundation without exposure to ruinous financial penalties. That limit, whose rationale was to remove the opportunity for self-dealing between founders and their SOCs, was surely overkill in that respect, as are the 2019 tax reforms that leave EFs viable in principle but require that they own 100% of the stock of their respective SOCs. In short, US tax policy regarding EFs is now concerned primarily with limiting the potential that EFs provide for opportunistic evasion of taxes, and not with preventing privately held firms from leaving the country.

If in fact law favouring EFs is largely the product of economic nationalism, it may be difficult to refine that policy by determining which EFs are in the national interest – and should be encouraged – and which are not. Additionally, it may be even more difficult to implement that distinction through the reform of general organizational law and tax law.

In short, Steen Thomsen and his fellow scholars may have some hard – and very important – work cut out for them.

Henry Hansmann
Yale Law School
October 2022

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