

QuickLaunch University Webinar: Determining Choice of Entity

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Speakers



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Entity Choice

Which type of entity should we choose?

- Possibilities:
 - Sole Proprietorship
 - General Partnership
 - Limited Partnership
 - Limited Liability Company
 - Subchapter C Corporation
 - Subchapter S Corporation
 - Public Benefit Corporation
- Considerations:
 - Tax
 - Liability
 - Number and Types of Owners
 - Funding Plans
 - Complexity/Administration
 - Cost
 - Public benefit; Strategic value



Entity Choice: Sole Proprietorship

Sole Proprietorship

- No business entity to set up
 - Generally just a “doing business as” (DBA) certificate
- One level of taxation filed on personal tax return
- Business owned by one person
- Unlimited liability
- Must obtain federal employer identification number (EIN) if you have employees (www.irs.gov)



Entity Choice: General Partnership

Partnership

- “Pass through” tax treatment
 - Partnership need only file informational tax return
 - Taxes reported directly on partners’ personal tax returns
- No limit on number or types of owners
- All partners can participate in the business
- Partners have unlimited liability
- Not an investor-favored form
- Can be formed orally or through actions
- Must obtain federal EIN (employees or not)



Entity Choice: Limited Partnership

Limited Partnership

- “Pass through” tax treatment
 - Partnership need only file informational tax return
 - Taxes reported directly on partners’ personal tax returns
- Business controlled by at least two people: one general partner and one limited partner
 - General partner manages business
 - Limited partners do not
- Only limited partners have limited liability
- Not a venture investor-favored form
- Must obtain federal EIN (employees or not)
- Should have a limited partnership agreement



Entity Choice: Limited Liability Company

Limited Liability Company (LLC)

- “Pass through” tax treatment
 - If two owners, taxed as a partnership; if one owner, taxed as a sole proprietorship
- No limit on number or types of owners
- All owners have limited liability
- Not a venture investor-favored form
- Cost and time to administer
- Must obtain federal EIN if you have employees or if there is more than one member
- Should have an operating agreement



Entity Choice: C Corporation

Subchapter C Corporation

- All owners have limited liability
- No limit on number and types of owners
- No “pass through” tax treatment
- Investor-favored form
- Entity owned by stockholders
- Controlled by board of directors and officers
- Must obtain federal EIN (employees or not)



Entity Choice: S Corporation

Subchapter S Corporation

- “Pass through” tax treatment
 - Similar to, but different from a partnership (certain states tax at the corporate level, such as CA and MA)
- All owners have limited liability
- Limit on number and types of owners
- Limit on classes of equity
- Not an investor-favored form



Entity Choice: S Corporation

Additional Requirements

- Must file Form 2553 to elect S-Corporation status
 - If filing invalid or if terminated, corporation will be taxed as C corporation
- Individuals, certain trusts, estates and charitable organizations may be owners
- Individuals must be either U.S. citizens or permanent residents
- No more than 100 owners
- One class of stock only



Entity Choice: Public Benefit Corporation

Public Benefit Corporation (“PBC”)

- Not a non-profit
- Not available in all States
- Formed the same way as a corporation
- Certificate of Incorporation must identify one or more specific public benefits
- Public benefit: positive impact on people, entities or interests (e.g., artistic, charitable, cultural, educational, environmental, literary, medical, religious, scientific, etc.)
- Name of company must clearly identify the company as a PBC
- Must regularly send stockholders a statement regarding its promotion of the stated public benefits



Entity Choice: Public Benefit Corporation

Public Benefit Corporation (“PBC”)

- Managed to balance shareholder interests and the public benefits stated in the Charter; May provide more fiduciary flexibility
- Query whether it is an investor-favored form
- Taxed like a C Corporation or S Corporation
- Difference from “B-Corps”, which are certified to meet rigorous standards of social and environmental performance, accountability and transparency by B-Lab
- B-Corps do not need to be (but may be) formed as Public Benefit Corporations



Entity Choice: Comparison Chart

Entity Type	Number of People	Separate Entity?	Limited Liability
Sole Proprietorship	1	No	No
General Partnership or Limited Partnership	2+	Yes	GPs: No LPs: Yes
C-Corporation	1+	Yes	Yes
S-Corporation	1+	Yes	Yes
Limited Liability Company	1+	Yes	Yes
Public Benefit Corporation	1+	Yes	Yes



Entity Choice: Tax Considerations

Entity	Who Files a Return?	Who Pays?	NOTE
Sole Proprietor or Single Member LLC	Sole Proprietor / Single Member	Sole Proprietor / Single Member	Business income and loss reported on Schedule C of Sole Proprietor or Single Member's Form 1040
General Partnership; Limited Partnership or Limited Liability Company (<i>with more than one member</i>) ¹	General Partnership and Partners; Limited Partnership and Partners; Limited Liability Company and Members	Partners; Members	Partnership or Limited Liability Company income and loss reported to Partners or Members on Schedule K-1 prepared by Partnership or Limited Liability Company; Partners and Members reflect income on personal tax returns and pay taxes
C-Corporation	Corporation and Shareholders	Corporation and Shareholders	Corporation pays taxes on its income and dividends to shareholders are taxed (double taxation)
S-Corporation	S-Corporation and Shareholders	Shareholders except some states tax impose tax on the corporation	Corporation income and loss reported on Schedule K-1 prepared by Corporation and shareholders reflect income on personal tax returns

¹ Assumes that the LLC has not elected to be a C or S Corporation



Entity Choice: LLC vs. C-Corp

- Two most common entities for emerging companies
- Can choose LLC then change later to a corporation
 - This is done frequently
 - But the change later may be expensive



Entity Choice: LLC vs. C-Corp

Pros of an LLC

- Tax benefits
 - Pass-through taxation
 - Can spin-off divisions tax free
 - If exit through asset sale, only one layer of tax
- Flexibility of management
 - Custom-tailor rules on governance/formalities
 - Fewer levels of management: Can be member-managed
- Flexibility of economics
 - Economics can be agreed upon, not just based on shares



Entity Choice: LLC vs. C-Corp

Cons of an LLC

- Not standard form for venture capital
- Tax benefits rarely realized or usable
 - Emerging companies rarely declare dividends
 - Passive losses may not be usable by members
- Can create adverse tax consequences for investors
 - Cash flow issues if there are no distributions
 - Tax-exempt investors may pay taxes on profit
- Higher legal, accounting, and administrative costs
- Employee equity is more complex



Entity Choice: LLC vs. C-Corp

Pros of a C-Corp

- Preferred form for venture capital
- Decades of well-established law
- Availability of good forms = lower legal fees
- Form of equity compensation are well established = lower legal fees
- Benefits in connection with exits
 - IPOs are much easier
 - Tax-free exit in stock-for-stock exchange



Entity Choice: LLC vs. C-Corp

Cons of a C-Corp

- “Double taxation”
 - Profits taxed once at the corporate level and again at the individual level when distributions are made
- Not as flexible as an LLC



Where to incorporate?

Delaware

- The standard for many investors
- Well-defined statute and case law
- High-quality courts and state administration
- But still must qualify to do business locally

State of Operation

- Lower administrative burden
- Not required to have an agent in DE (lawsuits)
- Possibility (depends on state) of lower franchise tax



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- A website full of vital information, tools and connections needed to position entrepreneurs and startups for success
- Draws on expertise of WH's extensive team of lawyers practicing in areas critical to emerging companies in various stages of growth
- Features a growing library of video insights from lawyers, investors and other experts
- Allows entrepreneurs and investors to build knowledge, research topics with everyday impact and connect with dedicated lawyers

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Questions?

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