

# Startups as a Commercialization Vehicle

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# Reasons to Form a New Entity

- Profit v. Non-Profit
- Isolate Assets
- Isolate Liabilities
- Difference in Ownership
- Tax benefits to Investors
  - Va. Code § 58.1-339.4
- Raise Money?

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# Challenges of Having a Separate Entity

- Management
- Administrative (accounting, legal)
- Investors

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# What Type of Entity?

- C-Corp
- LLC

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# Benefits of Both for Startup

- Multiple classes of ownership
- Unlimited owners permitted
- Limited liability
- Easily transferable interests

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# C-Corporation

- VC's preferred entity
- Well developed law
- Simple but rigid structure
- Going public
- Opaque (Non-pass through)
- Managed by Officers and Directors
  - need not be owners

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# LLC

- Preferred by individual investors
- Maximum flexibility in structure (some would say too much)
- Transparent (Pass through)
- Ability to separate management interest from financial
- Managed by members or by managers
- Managers need not be owners
- Easily converted to corporation

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# Hybrid for Tech Transfer Startups

- Begins as LLC
  - Tax benefits for initial investors
    - Tax credit
    - Deductions for losses
- Convert at major funding event
  - Members become common stockholders
  - Investors receive preferred stock

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# Financing Options

- Banks
- Friends and family
- Individual Angels
- Angel Funds
- Venture Capital
- Private Equity

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# Equity

- Corporations:
  - Common stock
  - Preferred Stock
  - Warrants
  - Equity carries with it a vote, which may be limited but not eliminated
- LLC:
  - Membership Interests
  - Ability to separate equity ownership from management
- Both can have option plans

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# Debt

- Conventional debt
  - Guaranty
  - Confession of judgment
- Convertible debt
  - Mandatory conversion
  - Optional conversion
- Subordinated debt

# Tax Considerations

- C-Corp deductibility of interest payments
- Accumulation of cash
- LLC flow through of losses
  - Passive investment v. active management

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