
Some Tips for Choosing the Best Entity for your Business

- i. Who will the investors be?
 1. If the investors and owners will be a small group of individuals, the possibilities are:
 - a. Partnership,
 - b. S corporation, or
 - c. LLC
 2. If the business requires venture capital or other types of professional investors, a C corporation may be more suitable
 - a. Rationale: a C corporation offers the most flexibility in incentive stock option plans, as well as various types of preferred securities, all of which is important in a venture-backed, high potential venture. A public offering will most likely require a C corporation.
 - b. Rationale for why such a business can't be an S corporation: VC firms cannot be shareholders in S corporations b/c VC firms are usually partnerships which is expressly prohibited in the S corporation.
 - c. Rationale for why such a business can't be an LLC: Potential tax liability of a flow-through entity makes VCs and their limited partners nervous so VCs do n/ invest in LLCs.
- ii. What are the capital requirements and cash flow characteristics of the business likely to be?
 1. If the business is projected to create large losses in the early years, then there may be some benefit to passing these losses through to investors, especially if the investors are in a possession to use them to offset income and to reduce personal income taxes. This fact

favors:

a. Partnership or

b. LLC

2. If the business intends to generate substantial cash flow and return it to investors as the primary means of creating value for investors then a flow-through entity becomes attractive.
3. If the business will require cash investment over the long term, and value will be generated through a sale or public offering, then the C corporation is most attractive.

iii. At the end of the day, the right choice depends upon the totality of a number of factors:

1. Who will own the business?
2. Who will manage it?
3. Who will reap any profit?
4. Who will bear the risk of any loss?
5. Who will pay income tax on any business profit?