Starting a New Business in the Wake of Tax Reform

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Joe Struble
210.250.6148
joe.struble@strasburger.com
Why a business entity in the first place?

1. Liability protection
2. Asset protection
3. Identification of asset ownership
4. Value generation
5. Transferability
Liability Protection

• Liability shield – protects your personal assets.

• Respect the formalities by executing documents on behalf of the company to enable the liability shield.

• You are always personally liable for your own bad acts. No liability shield for fraud, tax evasion, criminal acts, abuse of entity form (personal piggybank) that you take part in.
New Complexity: Capital Growth vs. Cash Flow?

- Corporation: 21% flat rate plus tax on distributions of 20+% (C-corporation tax); does not expire
- LLC: Personal tax rate with new 20% deduction--this benefit expires in 2025; healthcare, financial services and other services do not qualify for 20% deduction.
- For capital growth over the long term, a corporation has big advantages.
- If all income is distributed to the owners then an LLC in many cases will come out ahead.
The Corporation in a Nutshell

• Good for accumulating money (capital) to reinvest and grow.

• Attractive to equity investors → Qualified Small Business Stock? *Corporation + 5 yr hold required for investors = 0% tax on capital gain*

• Easier to issue equity incentives to employees.

• Easier to keep accounting and tax books.

• Foreign income may not be subject to U.S. tax.

• Formal structure with lots of rules and law.
The LLC in Nutshell

• Considered the most flexible business entity.
• Good for distributing cash flow to the owners, especially if 20% deduction applies or low profits.
• Overall attractiveness may be diminished for new businesses, especially start-ups.
• “Partnership tax” is complex set of tax and accounting rules.
• Ability to convert an LLC taxed as partnership to C-Corporation down the road?
Management and Equity Structure

• Corporation: “Directors” manage the company, “Shareholders” own the company.

• LLC: “Managers” manage the company, “Members” own the Company.

• Corporations and LLCs typically both have officers with day-to-day leadership positions – CEO, CTO, CFO, COO, VP, Treasurer and Secretary
Equity & Incentives

• Voting and Non-Voting Equity

• Restricted Stock and Stock Options - *When receiving an option always remember to consider making the 83(b) election. Only a short time window. Get help!*

• Others: Profits Interests, Phantom Equity
Beyond Entity Form – Securing Assets and Expectations

• Founders Agreement – assignment of existing IP
• Employment Agreement – ongoing assignment of IP
• What are the Service Requirements?
• Voting Control and Thresholds
• Who has Management Control?
• What is the Exit Plan?