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HOW TO CHOOSE YOUR BUSINESS STRUCTURE

The entity type can be very confusing for first time entrepreneurs launching a business. This is often made worse due to the wide variety of very generalized and opinionated pieces of advice strewn around the web today. Your choice can make a lot of difference later on, especially if planning to raise capital. Just don't let this relatively small step in the journey slow you down.

Types of Legal Entity to Choose From

Here are some of the most common business formation options. Before choosing one, I would highly recommend seeking legal guidance from a good corporate lawyer.

Sole Proprietorship

This is one of the most common default ways to operate for independent professionals, solo entrepreneurs and new small business owners. It is seen as being the easiest way to get going, with the least cost, and lowest paperwork and managerial burden. The downsides include no personal liability protection, and no option to scale by adding additional owners.

Partnerships

Partnerships are another common form of entity for smaller and closely held ventures. However, unless formed as a Limited Liability Partnership (LLP) owners can be entirely exposed to

Limited Liability Companies

LLCs have become much more popular in the last couple of decades. Many of the wealthiest real estate ventures in New York are structured as LLCs.

These structures offer protection from liability like a C Corporation, with more flexibility in how taxes are elected to be taken. These can be good investment vehicles with one Managing Member who actively makes operating decisions, while others can participate as passive investors.

S Corps

S Corporations are more of a hybrid corporate structure. They are limited to just 100 owners, and one class of stock. This makes them very unattractive for most VC and angel investors. Taxation can be preferable with the ability to avoid the double taxation of C Corps. Though entrepreneurs are still encumbered by the meetings and extra paperwork of a regular C Corporation.

C Corporations

C Corporations are what you will encounter with most public companies. There is more burden of organization, and the potential for more taxes. Though the flexibility in size and classes of stock make them far more attractive to investors. If you are looking to go the hyper growth route with raising VC money this may be the best path.

In this regard, when seeking financing the corporate structure will also be shared inside investor materials. This may be part of the appendix of your pitch deck. For a winning deck, take a look at the pitch deck template created by Silicon Valley legend, Peter Thiel (see it here) that I recently covered. Thiel was the first angel investor in Facebook with a $500K check that turned into more than $1 billion in cash. Moreover, I also provided a commentary on a pitch deck from an Uber competitor that has raised over $400 million (see it here).

Deciding Factors When Choosing a Corporate Structure

While this shouldn't be a step that slows down your venture, here are some of the factors to consider before choosing.

Taxes

Ultimately, in business and investments it isn't how much you make, but how much you get to keep which is most important. Getting trapped with double taxes and higher rates of taxes can be truly frustrating. Some structures may also allow carry over of losses in early years to years when there are profits and tax bills.

Costs

It is relatively inexpensive to set up any of the above corporate structures. How well you do it, and who you have do it will make most of the difference in costs. Securing nonprofit status or setting up trusts or going offshore may add to expenses. You'll also have to file annual reports and pay for renewals with some types of company. These fees can vary depending on the state or jurisdiction you form in.

Management Burden

Management burden can add to ongoing costs as well. If you are adamant this is a small part time hobby, you probably don't want to be buried under extra meeting, recording and paperwork requirements.

Flexibility

Some entity types offer more ability to switch and scale. For example, switching from an S Corp to C Corp as you grow.

Future Needs & Goals

Know your goals before you incorporate. If you know your plan is to raise capital or go public as an exit strategy, then it can make more sense to pick an entity that allows you to do that without any extra steps or delays later on. Don't do everything else right to set up a great fundraising campaign, and then hit roadblocks because your entity is all wrong.

Summary

There are a variety of options when it comes to choosing your corporate structure. Each carries its own pros and cons. Know what your drivers are before selecting.

Each accountant and lawyer may have their own opinions about which ones they prefer or know best. Always get personalized advice and from attorneys, CPAs and a consultant with startup experience so that you secure the format which really works best for you.