Why you should incorporate your business venture from the start

When starting a company, many entrepreneurs skip right over the formation process and jump straight into operations. But there are many benefits to incorporation that make the formation process worth getting right from the start.

What is the main benefit of incorporating?

Incorporation creates a "corporate veil" which limits the personal individual liability of founders and other stakeholders.

Limited liability is vitally important if the company is sued. With the protection of the "corporate veil," the assets of the corporation will be the only assets available to satisfy a claim.

If founders have not incorporated and they conduct startup business in their individual names, *then their personal assets are at risk*. These assets can be accessed to pay claims against the business.

What are some other benefits of forming a corporation over other entities?

There are various entity forms to consider when starting a company, including C corporations, S corporations, and LLCs. These options are discussed below, but ultimately, there are many reasons that recommend that scalable tech startups choose a Delaware C corporation structure.

C corps have become the most popular entity in the tech startup ecosystem. C corps can easily issue stock and options to an unlimited number of employees. They can issue multiple classes of stock, such as the preferred stock commonly issued to venture investors. There are no US residency restrictions on who can hold the company's stock. Investors are familiar with these benefits and expect their portfolio companies to be C corps, absent some very compelling reason to choose another form.

S corp is often an appropriate form for a closely held or family owned business that will not seek external financing. S corps have no corporate-level tax, only a single level of taxation passed through to the stockholder level. That can result in tax savings for companies with income. However, S corps present some problematic limitations for tech startups in high-growth global mode. An S corps can have a maximum of 100 stockholders and is prohibited from having non-US stockholders. It is not a fit for a company planning to grant employee equity incentives to a large workforce, hire outside the US or raise funds with international investors. For many startups, though, the ultimate deal breaker for S corps may be that they cannot issue multiple classes of stock, such as preferred stock, the universally accepted investment security of the venture community.

LLCs are a hybrid form, with the dual benefits of pass-through taxation (like an S Corp or a partnership) and the limited liability of a corporation. LLCs work well for high-cash-flow businesses like consulting firms and construction firms which might pay high income tax. But tech startups generally do not have this problem in early stages, and LLCs have disadvantages within the traditional VC-backed tech company startup model. There are challenges with granting equity incentives to employees and issuing preferred stock to outside investors, and taking an LLC public has unique issues, so this form is not popular for tech startups.

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Why are most startups formed in Delaware?

Delaware has become the favored jurisdiction for tech corporations. The state confers a number of benefits, among them:

1. Delaware corporations are easy to form and manage.
2. The corporate laws and courts in Delaware are generally business favorable.
3. Delaware's Secretary of State Office is customer friendly, with long working hours and quick turnaround times.
4. State franchise taxes and filing fees are fairly low.

If you have a startup business that will require third party equity financing to get to scale, we recommend starting as a Delaware C Corp. It is more expensive to change the entity form later and there are very few downsides to forming a Delaware C Corp from the start. But please do not panic when you get your first Delaware franchise tax bill. The initial bill is almost always way off the mark, at hundreds of times the actual cost (for instance, a bill for US$50,000 versus the actual tax due of around US$500). We are experienced in working with Delaware authorities to correct the calculations quickly.
