Choosing an Entity: Comparison Chart

One of the first major decisions a startup founder makes is selecting an entity structure. Each type of entity has its own advantages and disadvantages. This chart compares the C Corp and LLC structures, to help guide founders in choosing the most appropriate entity.

Issue	C Corporation (C Corp)	Limited Liability Company (LLC)
Taxation	**Advantages** The net operating loss of a corporation may be carried back and forward against corporate income (subject to limitations), but is not directly passed through to shareholders. The ability to carry forward net operating losses has cash flow benefits. In particular, once the company becomes profitable, a C corporation is usually able to offset its net operating losses against its early taxable income, thus sheltering the company's precious cash while it remains in the development stage. Overall, during the first few years of profitability, when venture-stage companies typically wish to reinvest as much of their earnings as possible into continued expansion, they are normally able to conserve considerably more operating capital if they are organized as C corporations rather than as LLCs. **Disadvantages** The use of a C corporation requires taxation at both the corporate and shareholder level (*ie*, double tax). One consequence of this is that there is no pass-through of losses to shareholders in the early years when the venture is experiencing losses.	**Advantages** Pass-through taxation avoids double taxation at the corporate and shareholder level, with only the shareholder paying tax. **Disadvantages** Tax structure may encourage distribution of capital to LLC members (to enable them to pay taxes on their allocated portions of the LLC's taxable income), thereby reducing capital available for the venture.

Personal Liability	No personal liability.	No personal liability.
Ownership Interests	**Advantages** Allows issuance of multiple classes of stock, such as preferred stock, which grant the holder certain preferences over common stockholders (traditionally, institutional investors receive preferred stock in private companies) without imputing to the holder its profits and losses. **Disadvantages** None.	**Advantages** Allows issuance of different classes or series of membership interests that mimic the structure of multiple classes of stock in a corporation; however, instead of filing a certificate of incorporation with the state that sets forth the rights, preferences and privileges of the different membership classes, the members enter into private contractual agreements providing for such terms. **Disadvantages** None.
Transferability of Ownership Interests	**Advantages** Offers the most freely transferable interests and the transfer of such interests is the least complicated, because it does not affect the entity itself or the shareholders who are not parties to the transfer. **Disadvantages** None.	**Advantages** Allows for a member-managed or manager-managed structure, with the latter being more suitable for outside investors because it resembles a corporation's board structure. **Disadvantages** LLC membership interests may have heightened transfer restrictions; fewer investors may want to acquire such interests.
Operations and Management	**Advantages** Corporations are formed within the context of a highly evolved legal backdrop, consisting of extremely detailed statutes and centuries of	**Advantages** LLCs provide great flexibility in customizing operations and corporate governance because the Operating Agreement is a contract among

	judicial case law, that define broadly understood rules for corporate governance. **Disadvantages** Corporations have less flexibility to customize operational and corporate governance matters compared to LLCs due to requirements to adhere to corporate formalities as governed by state statute. Corporations typically have higher ongoing administrative costs.	parties. The parties are not subject to the stringent statutory rules that are applicable to a corporation. **Disadvantages** LLC statutes resemble partnership laws in that they impose far fewer set rules, instead requiring organizers to define control and financial relationships in a customized Operating Agreement. Since LLCs are a relatively recent statutory creation, there is comparatively little judicial case law to govern interpretation of such Operating Agreements. If a dispute on the Operating Agreement arises, there is not as much case law to provide certainty as to potential outcomes of the dispute compared to corporate case law. Operating Agreements must be drafted with extreme detail to compensate for this. Formation of an LLC for a venture-stage business therefore typically requires much more labor-intensive documentation than does the formation of a typical venture-stage corporation.
Familiarity to Third-Party Investors and Capital Markets	**Advantages** Financial investors' preferred entity structure, because it offers maximum flexibility in allocating control and varying the nature of the shareholders' equity investment in the entity. The corporate structure, with common and convertible preferred stock, is "standard" for venture-backed companies, and nearly all investors are familiar with the negotiating issues and documentation that accompany this structure. In contrast, an LLC's organizational documents typically must include extensive details on governance, accounting and tax matters. These details can be unfamiliar or confusing to investors used to dealing with corporate documentation. Potential investors routinely have numerous investment opportunities from which to choose, and	**Advantages** Sophisticated third-party investors will understand and appreciate the LLC structure in the context of a broad consortium, joint venture or similar alliance among strategic players. **Disadvantages** If in the future third-party equity is to be raised for the venture, then certain financial investors (such as VC funds) may not prefer an LLC structure. Also, if the venture is to conduct an IPO, it is likely that the LLC will need to convert to a corporate structure so that institutional and other investors will not be deterred by cumbersome prospectus disclosures pertaining to LLC governance, accounting and tax matters. From a procedural perspective, converting from

	documents that are nonstandard or more difficult to understand can be a basis for eliminating a company from further consideration. **Disadvantages** None.	an LLC to a corporation is feasible. However, companies that choose to organize as LLCs initially, with the idea of converting to a corporate form just before going public, often find that it can be unexpectedly complicated, particularly if the LLC's internal and external contractual relationships have not been carefully crafted with such a conversion in mind. For example, LLCs (like partnerships) often wind up with equity holders whose percentages of capital are different from their profit percentages; converting these holders to a percentage of corporate stock ownership requires careful contractual and tax planning from the inception of the company.
Employee Equity Incentive Plans	**Advantages** Best suited for allocating equity to employees because the entity can adopt a traditional stock option plan as well as grant incentive stock options. **Disadvantages** None.	**Advantages** None compared to a corporation. **Disadvantages** Structuring an equity incentive plan is complex, because the entity cannot adopt a traditional stock option plan or grant incentive stock options and can only grant profit interests or non-qualified options, which require careful valuation and tax analysis.