Selecting and Forming the Business Entity

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§1 Introduction

While the founders may initially interact with each other on an informal basis it is important for them to consider at a very early stage what should be done about selecting the legal form of business entity for their new venture and completing the prescribed process for forming and organizing the chosen entity. Without planning in this area the founders will be treated as a partnership for legal purposes and find that they are subject to personal liability for all actions taken by any of the founders in furtherance of the new business. Attempting to develop and launch a new technology or product is risky enough for the founders without putting all of their personal assets on the table. As such, the first priority for the founders should be to limit their personal liability for the debts and obligations of the new business. Beyond that the founders need to choose an entity form that provides them with the best tax treatment and clarity as to how they can work together and interact with outside parties.

For illustrative purposes the discussion in this Guide is based on the assumption that the founders will be forming their new company in the US and will be subject to US laws pertaining to business organizations and taxes. Obviously selecting and forming a new business entity outside of the US will require a thorough understanding of applicable local laws and guidance from experience professional advisors; however, many of the same factors relating to selecting the form of business entity will apply regardless of the jurisdiction. For example, founders everywhere will want to select an entity that gives them maximum flexibility for raising capital and allocating operational control and which also limits their liability and provides them with opportunities to reduce their tax obligations with respect to income generated by the business. Choice of entity also requires attention to fiduciary obligations, restrictions on transfer of ownership interests and, of course, compliance with specific legal requirements imposed on the type of business which might be conducted by the entity.

In the US the primary options for two or more entrepreneurs looking to form a new business entity are a partnership, which can be further classified into general or limited partnerships; a corporation taxed as such under Subchapter C of the Internal Revenue Code (“IRC”), a corporation treated as a pass-through entity for tax purposes under Subchapter S of the IRC, and a limited liability company (“LLC”). The process of selecting the proper form of business entity generally requires a comparison of the entities in relation to a variety of distinguishing factors as they apply to the specific business and the requirements of the owners. Although each form of business entity has its own unique legal framework and requirements as to formation and operation of the enterprise, many of the historic differences among the entities are eroding. The selection factors are numerous; however, the key questions are when will the business begin to be profitable and when, if ever, will the founders bring in outside investors and offer equity.
interests to other employees. The choice is not irrevocable and the business form can be changed when necessary through conversion. In fact, a growing trend is to begin by organizing the business as an LLC, which allows the founders to enjoy limited liability and to use early losses to their advantage for tax purposes, and then convert to a so-called “C Corporation” when profits begin to come in and venture capitalists show an interest in providing substantial amounts of new capital. It is also important to remember that the choice of the business form does not itself guarantee the success of the enterprise, although the improper form may contribute to its ultimate failure. The proper form should provide a means for the participants to achieve the desired results and should not unduly constrain the freedom of the participants to establish and maintain a network of contractual relationships that suit their own unique business considerations.

§2 Distinguishing factors among business entities

In order to make the right choice about the form of business entity one must first understand some of the reference points used to identify differences among the various alternatives. It is fair to say that each of the potential business entities can generally be distinguished by reference to:

- The formalities associated with forming and organizing the entity;
- The manner in which the entity facilitates fulfillment of the capital requirements of the underlying business;
- The rights of the principals to participate in management of the activities of the business and enter into legally binding contracts with outside parties on behalf of the business;
- The allocation of profits and losses among the principals;
- The extent to which the principals will be personally liable for the debts and obligations of the business;
- The ability of the principals to transfer their ownership interests without causing a disruption or termination of the business;
- The effect of the death, withdrawal or retirement of any of the principals on the continued existence of the business; and
- The income tax consequences associated with forming, operating, making distributions from, and terminating, the entity, as well as the income tax consequences of transferring an ownership interest back to the entity or to another party (i.e., another owner or an outside party).

§3 Non-tax classification of business entities

In the US the basic business organizational forms from the non-tax perspective include the sole proprietorship, which will not be discussed in this Guide since it is only relevant in situations where there will be a single owner of the business; the partnership, which can be further classified into general or limited partnerships; the corporation, including the regular corporation, statutory close corporations and professional corporations; and the LLC. Other organizational forms, such as a business trust or a registered limited
liability partnership, may be used in certain instances. Moreover, two or more of the organizational forms may be combined to operate a specific business, such as a limited partnership which is operated by a corporation acting as the general partner.

From a non-tax perspective, each of the business entities are generally distinguished by reference to the following characteristics: centralization of management and control, which refers to the ability of the principals to limit participation in day-to-day management to a small group of owners and agents; limitation of owners’ liability to the assets they contributed to the enterprise; free transferability of ownership interests; and continuity of the enterprise following specified events, including the death, withdrawal or retirement of any of the owners. While these characteristics provide a good foundation for comparing and contrasting the various business entities, it should be noted that their importance as distinguishing factors has diminished over time as efforts have been made to reduce unnecessary differences among the entities. For example, while the death, withdrawal or retirement of a general partner had traditionally triggered a termination and dissolution of the partnership, it is now relatively easy to ensure continuity of life for a partnership that permits the business of the partnership to survive the departure of a general partner if so desired by the other partners. In addition, the default rule for each of the entities has become perpetual life; however, it is permissible for the partners of a partnership or the members of an LLC to limit the term of the entity by contract.

As a general rule, the corporate form evidences each of the characteristics mentioned above. Corporate management and control is generally delegated by its owners, the shareholders, to the directors and officers of the corporation, creating a centralized management structure. Shareholders are not exposed to personal liability for the debts and obligations of the corporation, although they may lose what they actually invested in the business if things don’t go well. Shares may generally be freely transferred, even though reasonable transfer restrictions may be imposed by contract. Finally, unless the articles of incorporation or a shareholders’ agreement provides otherwise, a corporation has a continuous life that will survive the death, withdrawal or retirement of any of its principals, even when the corporation has just one shareholder.

Like corporations, limited partnerships also evidence centralization of management and control. Primary responsibility for managing the limited partnership business is vested in the general partners, who are exposed to unlimited personal liability for the debts and obligations of the partnership for doing so, and the limited partners sacrifice the opportunity to participate in day-to-day management of the business of the partnership in exchange for limited liability similar to that enjoyed by corporate shareholders. Like the shares of a corporation, limited partnership interests are generally freely transferable, although the partners often impose reasonable transfer restrictions as a matter of contract in their partnership agreement, and the death, withdrawal or retirement of a limited partner usually has no adverse impact on the continuation of the partnership business.

In contrast to corporations and limited partnerships, general partnerships have decentralized management since each of the owners has the right to participate in controlling the business as general partners, subject to any contrary agreement among
them. A general partner will be subject to unlimited personal liability for the debts and obligations of the business, although relatively easy precautions can be taken to shield individuals responsible for managing a partnership from having all of their personal assets at risk. A general partnership interest may not be transferred without the consent of the other partners and the death, withdrawal or retirement of any general partner can lead to the dissolution of the partnership and the termination of the partnership business, although that result can be avoided fairly easily through advance planning in the partnership agreement.

The LLC has attracted substantial attention due to the flexibility that it offers to the owners with respect to management and control while limiting their liability. For example, a “member-managed” LLC permits each of the owners to participate in the management of the business in the same way as a general partnership without the unlimited liability that is confronted by general partners. Alternatively, the owners can opt for a “manager-managed” LLC that looks like a corporation with centralized management and limited liability for all owners. Further nuances can be added to the managerial scheme of an LLC through the issuance of voting and non-voting interests.

While it is convenient to categorize the organizational forms by reference to objective characteristics, the founders should understand that it may be possible to use contractual provisions to deviate from the “default rules” provided by statute or common law to structure their legal relationships in a manner that suits their specific needs. For example, while a general partnership usually evidences decentralized management due to the ability of each of the partners to bind the partnership on their own based on agency theories, the partners may create a centralized management structure in their partnership agreement by providing for the appointment of a managing partner or a management committee of less than all of the general partners to handle the day-to-day operations of the business, although such an agreement does not necessarily eliminate the authority of the other partners to bind the partnership in the eyes of third parties. Conversely, the shareholders of a corporation with a small number of owners, a so-called “close corporation”, may agree among themselves in a shareholders’ agreement to dispense with a board of directors and allow each of them to participate directly in the operation and management of the corporate business in a manner similar to a general partnership.

The founders also need to realize that there may be legal and practical limitations on the rights and protections normally offered by a particular form of entity. For example, while limited partners generally are not liable for the business obligations of the limited partnership, their limited liability is conditioning upon their refraining from participating in the management of the limited partnership business. In addition, while the members of an LLC and corporate shareholders also enjoy limited liability, there are often situations where they will be required to deliver personal guarantees in order to secure financing for the business and if this is the case the limited liability offered by the legal entity is of little true value. It should be noted that the practical importance of limited liability depends on the situation and the proposed activities for the new business and that many potential liabilities may be managed and mitigated through insurance.
§4 Nonprofit organizations

By any measure, the nonprofit sector is a significant part of the American economy. The number of nonprofit organizations registered with the Internal Revenue Service exceeds 1.5 million and it has been estimated that the contribution of the nonprofit sector to the United States economy exceeds 5.5% of the country’s gross domestic product and that nonprofit organizations account for an estimated 10% of wages paid out to workers in the United States. In addition, nonprofit organizations of all types are important participants in social and political causes throughout the United States.

The predominant form of nonprofit organization is the corporation.¹ There are several distinctions between nonprofit and profit corporations: a business corporation generally exists to make a profit for its shareholders; however, a nonprofit corporation (particularly a charitable organization) exists primarily to advance a purpose or objective; a business corporation ultimately benefits the shareholder or shareholders, but nonprofit corporations generally do not have shareholders and are not even required to have a class of members that the organization serves; the goal and focus of the management of charitable organizations should be to advance the entity’s stated purposes, rather than the interests of any group of individuals affiliated with the charity; and although nonprofit organizations need revenues to sustain their operations, much of these revenues will be in the form of contributions or grants; the pursuit of enterprises or activities solely to generate a profit can jeopardize an organization’s tax exempt status.

In many states, nonprofit corporation laws are based on analogous provisions of the state’s corporate law applicable to general (“for-profit”) corporations. For many years, nonprofit corporation laws consisted of a few special rules for nonprofit corporations, with the balance of the regulatory scheme accomplished by incorporating the general corporation law by reference. This approach proved unsatisfactory, as nonprofit enterprises are fundamentally distinguishable from business corporations. To accommodate those distinctions, many states implemented wholesale revisions of their nonprofit corporation laws. A Model Nonprofit Corporation Act was originally drafted in 1952 and revised in 1964. A new version of the Model Act, the Revised Model Nonprofit Corporation Act was originally adopted in 1987 and last revised in 2008. The Revised Model Nonprofit Corporation Act was intended to be compatible with the Revised Model Business Corporation Act. While a many jurisdictions follow either the Model Act or the Revised Model Act, the approach taken in the other states such as Illinois, Missouri, Ohio, California and New York, varies substantially. Other states have a general corporate statute that governs both for-profit and nonprofit corporations.

Nonprofit corporations are formed pursuant to state statutes and may be classified as those governed by the statute applicable to nonprofit corporations in general; and those governed wholly or in part by a statute that is applicable only to a particular kind or kinds

¹ For full discussion of nonprofit corporations, see “Nonprofit Corporations” in Governance: A Library of Resources for Sustainable Entrepreneurs prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
of nonprofit corporations. Nonprofit corporations may also be classified as those having stock and those not having stock. Nonprofit corporations generally have no stock, but in some states the statutes authorize the issue of stock as a convenient method of evidencing and transferring membership interests. In some states nonprofit corporations are classified as membership corporations. They include a wide variety of types that are commonly governed by separate statutes not applicable to other nonprofit corporations.

Under state statutes patterned on the Revised Model Nonprofit Corporation Act, as well as the nonconforming statute used in California, each nonprofit corporation must identify itself in its articles of incorporation as a public benefit, mutual benefit, or religious corporation. Public benefit corporations are formed for public or charitable purposes. Public benefit corporations are generally exempt from federal taxation and include corporations formed to operate a school, museum, or hospital, assist the poor, or save the environment. In addition, civic leagues or social welfare organizations, each of which would be tax exempt, are likely to be public benefit corporations. Mutual benefit corporations may operate for any purpose of common interest to the organizers, except that if the corporation’s assets are irrevocably dedicated to charitable, religious, or public purposes, it may not be formed as a mutual benefit corporation. Therefore, a mutual benefit corporation is never exempt from federal income taxation, although it may be exempt, if it is, for example, a trade association or chamber of commerce, or a social club. Mutual benefit corporations are the least regulated, except to the extent that they hold assets in charitable trust, in which case they are subject to the higher level of scrutiny of public benefit corporations. If an organization is organized and operated for religious purposes, such as operating a church, synagogue, mosque, or temple, it should be formed as a religious corporation. Religious corporations, like public benefit corporations, are generally exempt from federal income taxation. While not entirely free of regulations, religious corporations are accorded a greater degree of autonomy and noninterference by public regulatory agencies. Other states have another classification—the nonprofit cooperative. The nonprofit cooperative can distribute some of its earnings to its members.

Although most nonprofit organizations are incorporated under one of the nonprofit corporation laws, some organizations operate without any formal organization, or choose to operate without filing articles of incorporation with the Secretary of State. These organizations are unincorporated associations. States may still have laws dealing with special situations, like humane societies, medical service corporations, health care service plans, chambers of commerce, mutual water companies, and consumer cooperative corporations. An advantage of a corporation over an unincorporated association is that the corporate entity is considered to be a “person” for legal purposes. Further, a corporation operates under a clearly defined set of rules of governance and law. The status of an unincorporated association and its members is less clear, particularly if the organization has out-of-state activities. In addition, if a corporation is properly formed and operated, it can offer somewhat more protection from personal liability to its individual directors, officers, shareholders or members.

In addition, a number of nonprofit organizations elect to operate as charitable trusts,
rather than as corporations. A charitable trust can be set up as a separate entity apart from a particular corporation under a specific trust agreement, or as a part of an estate plan. To be tax exempt, the charitable trust must comply with the same provisions for tax exemption as a nonprofit corporation. A charitable trust is subject to the general laws regarding trusts; however, the beneficiary, rather than being an individual or group of individuals, is a specific charitable entity or purpose (e.g., a trust set up to raise and manage funds to benefit an existing charitable organization or organizations). The principal benefit of using a trust is that there is no need to comply with corporate formalities. The principal disadvantage of using a trust is that the standard of conduct for trustees is generally stricter than the standard of conduct for corporate directors and generally requires more direct involvement of the trustees and less delegation.

Filing all of the proper documents to incorporate a nonprofit activity for state corporate law purposes does not make the entity automatically exempt from state or federal taxation. For most nonprofit corporations, including all charitable organizations, if the organization desires preferential tax treatment it must apply to the state taxing authority for a determination of the entity’s exempt status. In addition, nonprofit corporations must also apply to the Internal Revenue Service for a determination of exempt status for federal income tax purposes, unless the organization qualifies for an exception to this requirement, as in the case of religious organizations having an annual income of less than $5,000. If a corporation organized under a state’s nonprofit corporation law to pursue charitable objectives fails to obtain a favorable determination of its tax exempt status it will be taxed on the same basis as a business corporation.

Exempt organizations are initially divided between public charities and private foundations. Public charities are, as the name implies, publicly supported and include organizations like the United Way and March of Dimes, as well as churches, schools and hospitals. Private foundations, which are not publicly supported, are then divided between operating foundations and non-operating foundations. In addition to these fundamental distinctions, the Internal Revenue Code imposes specific requirements on various exempt entities. For example, a social club must not discriminate in membership qualifications on the basis of race, color or religion in order to remain exempt.

**Checklist for Formation and Organization of Nonprofit Corporation**

Each state has its own statutory requirements regarding the formation and organization of nonprofit corporations. As a general rule, however, the promoters of a new nonprofit corporation and their legal advisors should be sure that each of the following issues have been taken into account during the formation and organization stage:

- The principals of the organization should meet with counsel to gather all the information necessary to form and organize the corporation and make the required filings with federal and state tax authorities. Determine whether the principals want or needs a general pre-incorporation agreement and, if so, prepare the agreement.
- Determine where to incorporate and if qualification in a foreign state is necessary.
- Select a corporate name, check availability of corporate name, and reserve corporate name.
- Prepare a preliminary business plan outlining the proposed purposes and activities of the organization, including staffing and fundraising requirements. Verify that the proposed activities of the organization...
§5 Alternative legal architectures for sustainability-oriented businesses

Another potential impediment for sustainability initiatives that require investment of resources in activities that may appear to be unrelated to the traditional focus of corporations on maximizing profits for the stockholders is the fiduciary duties of the directors of the corporation. For example, when Henry Ford proposed to use surplus profits to hire additional employees to fight unemployment and increase benefits for employees rather than distribute such profits to the stockholders of Ford Motors, the Michigan Supreme Court, writing in 1919, found that Ford’s actions would breach his fiduciary duty of good faith to the corporation. The Court explained: “A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.” The Court also made it clear that “it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others”.

The fiduciary duties described in cases such as the one described above complicate efforts of directors to authorize sustainability initiatives that, by their very nature, are intended to create benefits for stakeholders other than stockholders that may well adversely impact stockholder value, at least in the short term, and deprive stockholders of distributions of surplus profits.\(^3\) In an effort to free directors of these constraints, and thus promote more aggressive and entrepreneurial sustainability efforts, lawmakers in more than half of the states have passed legislation that permit organizers to form special purpose corporations (generally referred to as “benefit corporations”) that are explicitly allowed to operate in a responsible and sustainable manner as a means for not only maximizing stockholder value but also providing benefits to society in general.\(^4\)

Maryland was the first state to adopt legislation recognizing a “benefit corporation”, which the statute described as a corporation formed to create a material positive impact on society; consider how decisions affect employees, community and the environment; and publicly report their social and environmental performance using established third-party standards.”\(^5\) In Maryland, a benefit corporation must create a “general public benefit”, which was defined as a material, positive impact on society and the environment, as measured by a third-party standard, through activities that promote a combination of specific public benefits including providing individuals or communities with beneficial products or services; promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; preserving the environment; improving human health; promoting the arts, sciences, or advancement of knowledge; and/or increasing the flow of capital to entities with a public benefit purpose.

While it is conceivable that a traditional for-profit corporation could pursue many of the “public benefit” activities mentioned above, the actions of the directors would be hamstrung by above-described case law that has clearly and continuously proclaimed that the directors’ duty of good faith to the corporation requires that they carry on the business of the corporation so as to maximize the profits of the stockholders. The statutes creating benefit corporations allow directors to consider the interests of stakeholders other than the stockholders. For example, while the Maryland statute did not create a separate duty of the director to the beneficiaries of the public benefit purposes of the corporation, it did mandate that directors must consider the effects of any action or decision not to act not only on the stockholders but also on the employees and workforce of the benefit corporation and the subsidiaries and suppliers of the corporation; the interests of customers as beneficiaries of the general or specific public benefit purposes of the benefit corporation; community and societal considerations, including those of any community in

\(^3\) For further discussion of fiduciary duties of directors, see “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
\(^4\) For further discussion of benefit corporations, see “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

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which offices or facilities of the corporation or the subsidiaries or suppliers of the benefit corporation are located, and the local and global environment.

When Delaware, the recognized leader in statutory and case law innovations in the area of corporate law, passed its statute in 2013 recognizing “public benefit corporations”, the Governor made the following observations:

“Delaware public benefit corporations will function like and enjoy all the same benefits as traditional Delaware corporations and they will have three unique features that make them potential game changers. These three features concern corporate purpose, accountability, and transparency.

Corporate Purpose: Delaware public benefit corporations will have a corporate purpose ‘to operate in a responsible and sustainable manner’. In addition, to provide directors, stockholders, and ultimately the courts, some direction, they are also required to identify in their certificate of incorporation a specific public benefit purpose the corporation is obligated to pursue. The overarching language helps ensure that a public benefit corporation serves the best long term interests of society while it creates value for its stockholders. The requirement to identify a specific public benefit purpose gives managers, directors, stockholders, and the courts, important guidance to ensure accountability, while preserving flexibility for business leaders and their investors to choose the specific public benefit purpose they feel will drive the greatest total value creation.

Accountability: Unlike in traditional corporations, whose directors have the sole fiduciary duty to maximize stockholder value, directors of public benefit corporations are required to meet a tri-partite balancing requirement consistent with its public benefit purpose. Directors are required to balance ‘the pecuniary interest of stockholders, the best interests of those materially affected by the corporation’s conduct, and the identified specific public benefit purpose.’

Transparency: Delaware public benefit corporations are required to report on their overall social and environmental performance, giving stockholders important information that, particularly when reported against a third party standard, can mitigate risk and reduce transaction costs. Given the trend in public equity markets toward integrated ESG (Environmental, Social and Governance) reporting and the growing private equity market for direct impact investing, this increased transparency can help investors to aggregate capital more easily as they are able to communicate more effectively the impact, and not just the return, of their investments.”

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In California, a “benefit corporation” may be formed for the purpose of creating general public benefit, defined as a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard that satisfies certain requirements. A benefit corporation may also identify one or more specific public benefits as an additional purpose of the corporation including, without limitation, providing low-income or underserved individuals or communities with beneficial products or services, promoting economic opportunity for individuals or communities beyond the creation of jobs in the ordinary course of business, preserving the environment and improving human health. Directors of benefit corporations are required to consider the impacts of any action or proposed action upon specified considerations including, among others, the shareholders and employees of the corporation, customers of the corporation who are beneficiaries of the general or specific public benefit purposes and the environment. In addition, directors of benefit corporations are allowed to consider the impacts of those actions on, among other things, the resources, intent, and conduct of any person seeking to acquire control of the benefit corporation. California benefit corporations must prepare an annual benefit report which includes, among other things, a statement indicating whether, in the board's opinion, the benefit corporation failed to pursue its general public benefit and any specific public benefit, a description of the ways in which the benefit corporation pursued those benefits, the extent to which those benefits were created and the process and rationale for selecting the third-party standard used to prepare the benefit reports.

While benefit corporations have attracted a significant amount of attention, there have been other attempts to create and popularize alternative business structures for social entrepreneurship. For example, a “L3C”, or “low-profit limited liability company”, is a for-profit, social enterprise venture that has a stated goal of performing a socially beneficial purpose, not maximizing income, which has been recognized by statute in a handful of states and tribal nations. The first state to recognize the L3C was Vermont, which defined it to mean an LLC organized for a business purpose that satisfies and is at all times operated to satisfy each of the following requirements: (A) the company significantly furthers the accomplishment of one or more charitable or educational purposes and would not have been formed but for the company’s relationship to the accomplishment of charitable or educational purposes; and (B) no significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property. Proponents of the L3C have touted the entity as embodying the operating efficiencies of a for-profit company along with a reduced regulatory structure. As an LLC, a L3C is able to bring together foundations, trusts, endowment funds, pension funds, individuals, corporations, other for-profits and government entities into an organization designed to achieve social

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7 See Ca. Corp. Code §§ 14600 et seq. The California Social Purpose Corporations Act authorizes and regulates the formation and operation of a “social purpose corporation”, which may be formed for special purposes, in addition to any other lawful purpose, including, but are not limited to, charitable and public purpose activities that could be carried out by a nonprofit public benefit corporation. See Ca. Corp. Code §§ 2500 et seq.
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objectives while also operating according to for-profit metrics. The L3C can also take advantage of the LLC structure to operate with the flexibility of membership and organization needed to cover a wide variety of social enterprise situations while including the liability protection of a corporation.  

Commentators have also suggested that the operating agreement of a traditional Delaware LLC may be drafted to create the same characteristics of purpose, accountability and transparency as benefit corporations. When the business is being operated as a traditional for-profit corporation the charter documents may be drafted to give control over the socially responsible mission of the company to a single class of shareholders, thus providing members of that class with veto power over certain corporate acts that may be at odds with a specific sustainability-related purpose that is of importance to a significant number of shareholders. In lieu of provisions in the charter documents, shareholders and officers of a traditional for-profit corporation may enter into contractual agreements pertaining to the mission. Another method that might be used is a licensing arrangement wherein valuable intellectual property is held by a non-profit or the founders in order to preserve the mission through a protective license back to the company. Finally, many social entrepreneurs choose to formally organize their mission-based businesses as a nonprofit corporation.

**Certified B Corporations**

B Lab Company (“B Lab”), a Pennsylvania nonprofit corporation, has been described as the driving force behind the adoption of benefit corporation legislation across the country. In addition to its role in developing the Model Benefit Corporation Legislation (“MBCL”) and working for its passage and use, B Lab is the certifying body for certification as a Certified B Corp., which offers access to the Certified B Corporation logo often seen as being a “Good Housekeeping Seal of Approval” for sustainable businesses. B Lab offers a free reporting tool for benefit corporations to meet transparency requirements, although B Lab has no role in overseeing the performance of benefit corporations or their compliance with the requirements of the MBCL. B Lab also offers a portfolio of services to, and a vibrant community of practice among, certified B corporations. The certification process reflects B Lab’s understanding that

8 For additional information on the L3C, see the website of Americans for Community Development (https://americansforcommunitydevelopment.org/). See also M. Carreira da Cruz, “Legal Innovation and Social Entrepreneurship Formats”, American International Journal of Contemporary Research, 2(10) (October 2012), 59 (discussing the L3C and efforts to create a new corporate format dedicated to social entrepreneurship in foreign countries such as Belgium, the United Kingdom and Luxemburg).

9 F. Alexander, E. Klinger-Wilensky and M. Divincenzo, “Certificate of Incorporation (DE): Public Benefit Corporation Provisions” (Thomson Reuters: Practical Law, 2016). Alexander et al. noted: “…the LLC structure is sufficiently flexible to create a benefit corporation-like arrangement through private ordering. In fact, many LLCs are already certified as “B Corps” (e.g., Urban Green Development, LLC; Blue Earth Consultants, LLC; Good Capital, LLC) by B Lab, a non-profit entity that certifies socially conscious business entities and that requires a legal structure that creates broad accountability. B Lab requires certain language in the operating agreement to ensure the LLC’s mission is aligned with its stakeholders.” The recommended B Lab language is reproduced as Appendix 10 to Alexander et al. The additional suggestions in this paragraph are based on S. Mac Cormac, “When and How to ‘B’—Responsible B Corp Conversion” (September 6, 2017), http://impact.mofo.com/category/corporate-form/.

10 For discussion of nonprofit corporations, see “Nonprofit Corporations” in “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
organization under the MBCL or other benefit corporation statute does not guarantee that a corporation’s
day-to-day operations meet the expectations of consumer or investors interested in developing relationships
with sustainable businesses.

B Lab has explained that certified B corporations are purpose-driven and create benefits for all
stakeholders, not just shareholders. According to B Lab, certified B corporations believe that we must be
the change we seek in the world; that all business ought to be conducted as if people and place mattered;
that, through their products, practices, and profits, businesses should aspire to do no harm and benefit all;
and to do so requires that we act with the understanding that we are each dependent upon another and thus
responsible for each other and future generations.

Certified B corporations and benefit corporations share the same characteristics with respect to
accountability and transparency (i.e., directors are required to consider the impact of the company’s
activities on all stakeholders and a report of overall social and performance assessed against a third party
standard must be prepared and publically published). As for performance, benefit corporations “self-
report” while certified B corporations must achieve a minimum verified score on a “B Impact Assessment”.
Benefit corporation status depends on the law of the particular state in which the corporation is organized;
however, B corporation status is available to every business regardless of corporate structure, state, or
country of incorporation. While benefit corporations must pay state filings, B corporations must pay
annual certification fees to B Lab based the amount of revenues from the company’s activities. During the
early years of “certified B corporations” there was no requirement that a company also be a benefit
corporation in order to be certified; however, from the end of 2017 onward obtaining and maintaining
Certified B Corp certification will require benefit corporation status, although it is not necessary that the
corporation be organized under a statute based on the MBCL (i.e., Delaware benefit corporation status, for
example, would be satisfactory).

The steps that must be completed for validating a company’s social and environmental performance are
referred to as the “assessment process” and begin with a “B Impact Assessment” that assess the overall
impact of the company on its stakeholders taking into account various factors such as number of
employees, sector and location of the company’s primary operations. The questions in the B Impact
Assessment have by created and revised by the Standards Advisory Council, a group of independent
experts in business and academia, and cover financial performance; suppliers; the impact of the business on
all its stakeholders; best practices regarding mission, measurement and governance; and the company’s
“impact business model”. Companies that complete the B Impact Assessment will receive a B Impact
Report that contains an overall score based on performance in three key impact areas (i.e., workers,
community and the environment) and will move on an assessment review and submission of supporting
documentation. At this point, the focus will be on the operations of the company and demonstration of
practice relating to the company’s social and environmental impact. Additional steps in the assessment
process include completion of a disclosure questionnaire, which allows companies to confidentially
disclose to B Lab any sensitive practices, fines and sanctions related to the company and its partners, and
background checks by B Lab staff which include a review of public records, news sources, and search
engines for company names, brands, executives/founders, and other relevant topics.

Around 10% of certified B corporations are randomly selected each year for an in-depth site review, which
takes place either in person or virtually and typically takes 6-10 hours depending on the size and scope of
the business. Site reviews are considered to be a crucial step for verifying the requirements of the Certified
B Corp. certification and confirming the accuracy of the responses of the specific company. Companies
wishing to maintain their Certified B Corp. certification are required to update their assessment every two
years by providing additional documentation and achieving a minimum score on the impact assessment.
Recertification requirements provide assurances that companies are continuing to engage in a high level of
impact with their stakeholders even as their businesses grow or change. The recertification process also
provides companies with opportunities to set their own internal improvement goals against B Lab standards
and benchmark their performance over time.

For complete information about becoming a Certified B Corp., see the B Lab website at
§6 Classification of business entities for tax purposes

In the US the basic “tax classifications” for “for profit” businesses include the proprietorship, which is taxed in the same manner as the individual who operates the proprietorship business and reports the tax items associated with the business on Schedule C of his or her individual tax return; the “partnership,” which includes both general and limited partnerships and, in most cases, LLCs; the “association,” which includes corporations which have not elected to be treated as a S corporation for tax purposes; and the corporation which has elected to be treated as a S corporation, and thus is taxed in much the same way as a partnership. The determination of how a business would be treated for tax purposes was historically based on rules that were clearly distinguishable from the non-tax characterization of the business; however, owners of a partnership or LLC are now allowed to file an election with the Internal Revenue Service (“IRS”) as to whether to have their entity treated as a partnership or association for income tax purposes.

Founders engaged in forming a new business should take care to consult with a tax expert who can guide them through all the complexities of the IRC and the potential tax problems that may arise as a result of a decision to have the entity taxed in a certain way. Simply put, however, the key tax planning consideration in selecting the entity follows from the fact that income generated by corporations which do not elect to be treated as a S corporation, referred to as C corporations, is taxed once at the corporate level and again upon distribution to the shareholders, although at the individual tax rates applicable to the income of the recipients, while income which is generated by partnerships—including LLCs treated as partnerships for tax purposes—and S corporations is not subject to tax at the entity level and is “passed-through” to the owners, included in their individual tax returns and taxed once at their individual rates. In addition, contributions of assets to the business, transfers of ownership interests, and termination of the business will each result in varying tax consequences to the owners depending on the form of entity.

§7 Advantages and disadvantages of partnerships

There are three major advantages to operating a business in the form of a partnership. One of the advantages is that a partnership is not a taxable entity, but rather a conduit through which income and loss flows directly to the partners. Thus, the double taxation problem that is inherent in C corporations is avoided. Additionally, most income, deductions, credits, and other tax items retain their character in the hands of the partners. For example, depreciation on partnership assets can be deducted directly by the partners. Further, partnership losses may be used by the partners to offset other income (although this is subject to certain limitations).
Another major advantage of partnerships is that there is generally no recognition of gain upon formation, without regard to whether the entity is controlled by the transferor immediately after the exchange. There are, however, certain circumstances under which gain will be recognized. Also, upon liquidation of a partnership, there is gain only if the cash distributed exceeds the partner's basis in the partnership. A distribution of property does not result in taxation. Liquidation of a corporation, on the other hand, calls for a tax on whatever is distributed to the extent it exceeds the shareholder's basis in that shareholder's stock. Further, a liquidation sale by a corporation of its assets means a tax to the corporation (assuming the sale is at a profit) and then a second tax when the funds are distributed to the shareholders.

Finally, a partnership is also the most flexible of the major entities. Within certain limitations, the partners can structure their relationship as they please. Income and losses from varying sources can be allocated in unequal amounts to the various partners. Even specific tax items can be apportioned unequally. In a C corporation the relationship is set forth in the various classes of stock issued. It is even more restricted in an S corporation, where only one class of stock is permitted, and allocations of pass-through items must be made in accordance with the pro-rata shareholdings. The partners are generally free to devise their own structure and procedures for management of the business; however, limited partners in a limited partnership will be restricted as to their actual participation in management decisions.

One of the main disadvantages to the partnership is that partners will be taxed on their share of income even if the partnership does not distribute funds, which may result in taxes having to be paid from assets or income from sources other than the partnership. Another disadvantage is that nonqualified retirement plans, deferred compensation plans, stock option plans, medical and dental plans, accident and health plans, group term life insurance, cafeteria plans, and employee death benefits are not available to partnerships. Although a qualified retirement plan may not be adopted by a partnership for its owners, the partners may get the same benefit through adopting Keogh plans.

There are also major potential nontax disadvantages to a partnership. The most important is that general partners are jointly and severally liable for all of the partnership debts. That liability extends not only to the value of the partner's investment in the partnership, but to all of his or her personal assets. Although most catastrophic liabilities can be insured against by a partnership, the risks of partnership form can still be significant. This general liability feature of the partnership works to undermine the entrepreneurial spirit. However, passive investors, unwilling or unable to be involved in the day-to-day management of the business, can be given limited partner status to cap their liability at the amount of their investment in the business. In addition, individuals actively involved in the management of a partnership may do so through separate entities, such as a corporation or single-member LLC, in order to limit their liability to value of the assets they contribute to that entity.

In addition, the creation of new ownership interests and the transfer of those interests within a partnership can also be quite cumbersome, thereby reducing the attractiveness of
the partnership form as the entity of choice in situations where there is to be a large number of owners and/or there is a desire to issue equity interests to employees and vendors. Problems are exacerbated in the case of a limited partnership, because limited partnership interests are securities for securities law purposes and thus are subject to additional regulation.

### Table 1
Advantages and Disadvantages of Partnerships

1. **General Partnerships**

   **Advantages:**
   1. Multiple owners can provide a combination of individual resources and talents.
   2. Minimal formalities are required for organization.
   3. Decision-making may be informal, although partnership agreement is generally used to establish procedures for making decisions.
   4. No qualification requirements for doing business in other states.
   5. Minimal reporting to governmental entities.
   6. Business profits are subject to only one tax, at the individual partner level, and are not subject to double tax as would be the case if the profits were realized by a C corporation.
   7. Losses are available on the partners' personal income tax returns and can offset other income (subject to the passive loss rules).
   8. Special allocations may be made for income tax purposes.
   9. Disproportionate distributions may be made to partners.

   **Disadvantages:**
   1. Partners have unlimited liability for obligations and liabilities of the business.
   2. Death, disability, or withdrawal of a partner may terminate partnership, although this can usually be handled by appropriate provisions in partnership agreement.
   3. All partners have the right to participate in management.
   4. All partners have broad authority to act on behalf of, and incur debts and liabilities for, the partnership.
   5. Business profits are taxed as income to the individual partners and, as a result, may be subject to self-employment tax as well as income tax.

2. **Limited Partnerships**

   **Advantages:**
   1. Limited partners enjoy limited liability.
   2. Only general partners participate in management so that limited partners can be equity owners without the general partners giving up control.
   3. There are no limitations on the number or types of partners.
   4. Existence is unaffected by the death or transfer of interest by a limited partner.
   5. Business profits are subject to only one tax, at the individual partner level, and are not subject to double tax as would be the case if the profits were realized by a C corporation.
   6. Losses are available on the partners' personal income tax returns and can offset other income (subject to the “at risk” and passive loss rules).
   7. Special allocations may be made for income tax purposes.
   8. Disproportionate distributions may be made to partners.
Disadvantages:

1. Formalities are required for organization.
2. Qualification is required for doing business in other states.
3. Regular reporting to governmental entities is required.
4. General partners have unlimited liability for obligations and liabilities of the business.
5. Death, disability, or withdrawal of a general partner may terminate partnership.
6. Limited partners have limited ability to participate in management or decision making.
7. Business profits are taxed as income to the individual partners and, as a result, may be subject to self-employment tax as well as income tax to the extent they are allocated to general partners.
8. Transfer of interests may be subject to securities law regulation.

§8 Advantages and disadvantages of regular corporations

The corporation is probably the best known and most common of the business entities. The general familiarity of all persons involved in commerce, finance and banking creates a feeling of acceptance and comfort when dealing with a corporation. For the foreseeable future—absent massive changes in federal and/or state tax laws—the corporation will remain one of the most commonly used entity forms, particularly when the business expands to the point where the number of owners is relatively large and the ownership group includes individuals and entities that are not involved in the day-to-day operation of the business.

As a general proposition (to which there are some exceptions), a corporation's shareholders have "limited liability." They are not personally liable for the debts of the corporation, but rather can only see their investment rendered worthless (or diminished) should the creditor pursue the corporate debtor. However, in a start-up environment, where the new corporation may have few assets and no credit history, the reality is that the founders may well be asked to personally guarantee such obligations, as a building lease, bank line of credit, or supplier credit. With fiscal success of the business, such guarantees may be expected to fall away.

Corporations enjoy relative ease in raising and operating capital and in transferring the ownership interest represented by its shares. In other words, it is relatively easy to buy and sell shares of stock as compared with the sale of assets or partnership interests. However, issuances and transfers of corporate securities must be done in a manner that complies with applicable federal and state securities laws. Corporations also offer ease of control at both the ownership level and in the management area for the majority shareholders. Voting rights depend on applicable state law. In some states, a majority of the shareholders can elect all members of the board of directors. In other states, however, including California, cumulative voting provisions assure minority shareholders of some representations on the board. In either case though, the majority of the shares can control the board and the selection of the management team. The shareholders, as a class, have no right to participate in the day-to-day management of a corporation as, for example, partners would in a general partnership. Moreover, in corporate form, outside investors can be issued nonvoting preferred shares so that the founders, despite a much smaller cash investment, can retain voting control.
Finally, another unique facet to the corporate form is the ability to limit the personal liability of directors with respect to actions brought by or in the right of the corporation for breach of the director's duties to the corporation and its shareholders. The scope of protection is determined by applicable state law; however, it normally does not extend to intentional misconduct, bad faith acts contrary to the corporation’s best interests, transactions from which a director derives improper personal benefit, reckless disregard of a director's duties, or an unexcused pattern of inattention to one's duties as a director.

Operating as a corporation can lead to a smaller tax bill than if the corporation did not exist. For example, the first $50,000 of earnings can be left in the corporation to be taxed at fifteen percent (15%), and the remainder can be drawn as salary. Depending on the other income of the taxpayer, part of that might be taxed as low as ten percent (10%), with the rest going into the fifteen percent (15%) and higher brackets. If the taxpayer has other income, leaving even more earnings in the corporation may save taxes (although leaving too much in the corporation may result in accumulated earnings taxes being applied). Additionally, the ability to establish a deferred compensation plan, a medical plan, group term insurance, and death benefits plan might, combined, be worth several percentage points of tax. A corporate retirement plan also has several minor advantages over a Keogh plan.

In situations where the business may face a problem with respect to passive losses, a C corporation may be the entity of choice. Any corporation in which more than fifty percent (50%) of the stock is owned by more than five individuals is not subject to the passive loss limitations. Even one with five or fewer stockholders can offset passive losses against business income (this is not true of a personal service corporation). In contrast, if the owners have profits from other passive operations, a partnership may be preferable so that losses may be used to offset passive income.

Corporations may be more expensive to maintain than other business forms. Costs to incorporate, exclusive of professional fees, can run to $2,500 depending on the state of incorporation and prudence dictates that records be kept of meetings of directors and shareholders, as well as share issue and transfer records. For a start-up company, it is rare that the founders will have these skills, so they must either be purchased or deferred, with the later creating its own set of problems. Partnerships, on the other hand, require little documentation to maintain the entity.

The two major tax disadvantages to conducting a business in corporate form are double taxation and the tax imposed upon liquidation of the corporation. Although double taxation is not a very attractive proposition, in practice, most corporations are small and are merely incorporated partnerships or sole proprietorships. In these types of situations, the corporation pays no tax at all, because the earnings are taken out by the shareholders in the form of deductible salary, bonuses, or other benefits. Dividend distributions are rarely, if ever, made so that double taxation never takes place. Another major tax disadvantage to corporations is that the liquidation of the corporation is a taxable event to the stockholders. This is also true of mergers and consolidations that do not meet
statutory requirements. Corporations may also be subject to additional rules if they become personal holding companies, if they fail to distribute earnings, if they issue preferred stock, or if they engage in many other actions covered by the IRC.

<table>
<thead>
<tr>
<th>Table 2</th>
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<tbody>
<tr>
<td><strong>Advantages and Disadvantages of Regular “C” Corporations</strong></td>
</tr>
<tr>
<td><strong>Advantages:</strong></td>
</tr>
<tr>
<td>1. All shareholders enjoy limited liability.</td>
</tr>
<tr>
<td>2. Ownership interests are freely transferable.</td>
</tr>
<tr>
<td>3. Perpetual existence unaffected by the death of shareholders or transfer of shares.</td>
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<tr>
<td>4. Centralized management.</td>
</tr>
<tr>
<td>5. No limitation on the number or types of shareholders.</td>
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<tr>
<td>6. Flexibility of financing is available through the sale of various types of securities to many investors.</td>
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<tr>
<td>7. Tax-favored fringe benefits are available to employee-shareholders.</td>
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<tr>
<td>8. Income is taxable at corporate rates, which are for the most part for the most part lower than individual rates.</td>
</tr>
<tr>
<td><strong>Disadvantages:</strong></td>
</tr>
<tr>
<td>1. Formalities are required for organization and operation.</td>
</tr>
<tr>
<td>2. Qualification is required for doing business in other states.</td>
</tr>
<tr>
<td>3. Regular reporting to governmental entities is required.</td>
</tr>
<tr>
<td>4. Income is subject to double taxation.</td>
</tr>
<tr>
<td>5. Losses of business may not be deducted by individual shareholders.</td>
</tr>
<tr>
<td>6. The distribution of property by a C corporation to its shareholders is generally a taxable event for income tax purposes as to both the corporation and the shareholders. Thus, withdrawing property from a corporation can be extremely expensive from a tax standpoint.</td>
</tr>
</tbody>
</table>

§9 Advantages and disadvantages of “S” corporations

If the founders decide to use a corporation for their business activities consideration must be given at the time the corporation is formed as to whether the shareholder group is eligible to elect “Subchapter S” status for tax purposes and whether such an election should be made. Failure to elect Subchapter S status in a timely fashion means that the corporation and its shareholders will be taxed in the manner described above for C corporations, which is the default method for corporate taxation. The choice between “S” and “C” status is entirely tax-driven and does not impact the shield from personal liability that the corporate form provides to shareholders. The principal difference, which can be significant, is that an S corporation is taxed in the same way as a partnership—a “pass through” entity with no tax at the entity level and allocation of the tax items associated with operation of the business to the shareholders and thus a single tax at the shareholder level. In contrast, the profits generated by a business operated as C corporation will be taxed at the corporate level and the resulting retained earnings will subsequently be taxed once again by the shareholder level when they are eventually distributed to the shareholders (e.g., in the form of dividend payments). Therefore, an S corporation combines many of the best features of both a partnership and a corporation from a tax
perspective. Limited liability is achieved through the corporate form, and the double tax of the corporate form is eliminated.

Shareholders cannot elect Subchapter S status for their corporation unless certain strict standards for eligibility are satisfied—no more than 100 shareholders; only one class of stock; and no partnerships, corporations or non-US residents within the shareholder group. Assuming these conditions are satisfied, the shareholders must unanimously approve the election and the appropriate filings must be made with the IRS and state tax authorities within a specified period after the later of the incorporation or formation of the company. The advantage of one form of corporation over another depends on a variety of factors. For example, an S corporation election may well make sense when it is expected that the business will be generating losses during the early years of operation and the shareholders can use those losses to offset other sources of personal income on their individual tax returns. On the other hand, if the business is fortunate enough to be generating profits from the very beginning it may make little sense to pass those profits through the shareholders immediately and have the profits taxed at high individual rates. Once an election is made it may be subsequently revoked; however, great care must be taken to understand and anticipate the tax consequences to the shareholders of revocation.

S corporations also have certain disadvantages. The need to adopt a simple capital structure has already been mentioned, and the transferability of ownership interests will be limited by the need to insure that all shareholders satisfy the requirements listed in the IRC. Another disadvantage to S corporations is that the deductibility of certain fringe benefits is limited. Medical reimbursements, disability retirement benefits, premiums on group term life insurance, and cafeteria plans paid to a stockholder holding a two percent (2%) or greater interest in the corporation are taxable to the shareholder but not deductible by the corporation. Also, there are differences in the tax treatment of distributions to the shareholders of an S corporation that may result in the recognition of gain, where a similar distribution to partners of a partnership would not be a taxable event. Finally, an S corporation's income is taxed to the shareholders regardless of whether the corporation actually distributes funds to the shareholders for use in paying the tax liability.

Regardless of the type of business and the expectations for development of the company, the choice between an S corporation and a C corporation always depends heavily on the specific individual tax situations of the various founders. Moreover, emerging companies present special issues given the need to consider providing equity to new employees and the real possibility of bringing in investors who will demand a different class of stock with special voting and economic rights. In order to understand the issues and potential conflicts that might arise when deciding whether an S corporation election should be made by the founders of an emerging company let us assume that one founder has no other sources of income and the other founder has income and losses from other businesses in which he has invested as well as from a professional service firm owned and operated by the founder’s spouse. It should also be assumed that both founders expect the new company to operate at a loss during the first year and that they share the view that the company will begin to generate profits in the second year that should be
Selecting and Forming the Business Entity

retained in the business and invested in marketing, product development, equipment and recruitment of additional managers and technical employees.

The founder with no other sources of income will have little interest in electing Subchapter S status for the new corporation since he or she would not be able to derive any personal tax benefit from using the losses generated by the business to offset other taxable income. Moreover, he or she would argue that corporate taxes are not likely to be an issue during the first year because it is expected that the business will operate at a loss or that whatever modest profits might arise from the business could be reduced or even eliminated by increasing salaries to employees within a reasonable range that would survive challenge by the IRS. Finally, since both of the founders have agreed that any profits during the early years would be reinvested in the business he or she would obviously not want to pay taxes on profits that were not being simultaneously distributed. On the other hand, the founder with other sources of income might well push for a Subchapter S election since he could write off the losses from the new company and reduce current taxes and/or build up tax loss carry-forwards that could be used in subsequent years. On balance, it is probably best to make the Subchapter S election when the founders are certain that the company will be operating at a loss during the start-up stage since the founder with other sources of income can gain some advantage and the other founder would not be harmed by the election.

Assuming a Subchapter S election is made when the founders are the only shareholders, it then becomes necessary to determine at what point the election will need to be terminated and the corporation and its shareholders taxed under Subchapter C (i.e., double taxation). The first scenario to consider is the expansion of the shareholder group to include outside investors. If capital is raised from private individual investors they may be willing to purchase common stock, and thus not violate the Subchapter S requirement of one class of stock, in order to use the early losses to offset other income on their tax returns; however, they will only invest with an understanding that the Subchapter S election will be terminated when the corporation becomes profitable. If capital is raised from professional investors organized in the partnership form (e.g., venture capitalists) the corporation would no longer be eligible for Subchapter S status and, in fact, a C corporation is the entity form of choice within the venture capital community. The second scenario to consider is the expansion of the shareholder group to include other employees who are issued shares in the company for incentive and compensation purposes. The impact of Subchapter S status on those employees depends on the same factors discussed above—the availability of other sources of income against which losses from the new company can be offset. Also, Subchapter S status would no longer be available once the number of shareholders exceeded 100. Finally, termination of Subchapter S status make sense when the new company becomes profitable and the consensus view among the shareholder group is that the profits should be retained and invested toward future growth. In that case failure to terminate the election would mean that shareholders would pay taxes on their pro-rate share of the profits without receiving a distribution of cash from the corporation to make the payments.

Table 3

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Advantages and Disadvantages of Special “S” Corporations

**Advantages:**

1. All shareholders enjoy limited liability.
2. Ownership interests are freely transferable (subject to restrictions imposed by contract to preserve S corporation status).
3. Perpetual existence unaffected by the death of shareholders or transfer of shares.
4. Centralized management.
5. Business profits are subject to only one tax, at the individual shareholder level, and are not subject to double tax as would be the case if the profits were realized by a C corporation.
6. Losses are available on the shareholders’ personal income tax returns and can offset other income (subject to the “at risk” and passive loss rules).

**Disadvantages:**

1. Formalities are required for organization and operation.
2. Qualification is required for doing business in other states.
3. Regular reporting to governmental entities is required.
4. Strict qualification rules must be met on a continuing basis, which among other things limit the number and types of shareholders.
5. The distribution of property by an S corporation to its shareholders is generally a taxable event for income tax purposes.

§10 Advantages and disadvantages of LLCs

In many ways, an LLC offers the best of both worlds. It is an entity that affords all of its owners the limited liability of a corporation, yet, it can be taxed as a partnership if the owners so choose. It is now common for fledgling emerging companies to be initially launched as an LLC and to operate in that form until it becomes necessary to seek and obtain capital from investors outside the founder group. An LLC combines the most important non-tax and tax advantages of corporations and partnerships. Like a corporation, an LLC limits the liability of its owners, referred to as members, for most of the debts and other financial obligations of the LLC provided that the requisite formalities of LLC legal operational requirements are observed. From a tax perspective, an LLC works in the same way as a partnership and is generally treated as a pass-through entity for tax purposes with no tax assessed at the LLC level and each member taxed individually on the LLC’s profits and losses. An LLC also offers more flexibility than a Subchapter S corporation in that the members may agree upon special allocations of profits and losses among the members in the same way as partnerships.

The fact that an LLC can be treated as a partnership for tax purposes provides it with several tax advantages over C and S corporations. Of course, because it is treated as a partnership for tax purposes, an LLC will not be subject to double taxation and the members are free to allocate income and loss under the rules applicable to partnerships. Also, an LLC that is taxed as a partnership does not generally recognize gain or loss upon liquidation. Only the members may be subject to tax on distributions received from the LLC’s liquidation. In addition, a C corporation may have a portion of the salary deduction
for an officer-shareholder disallowed as unreasonable compensation. Any disallowed portion would typically be treated for tax purposes as a dividend rather than as salary. In contrast, a LLC member's income is either taxed as a guaranteed payment or as the member's distributive share of LLC income.

LLCs are often compared to S corporations, because both offer limited liability and pass-through taxation. In general, LLCs offer a great deal of flexibility in relation to S corporations. For example, while S corporations are subject to certain restrictions on the number and type of shareholders they may have, as well as the number and variety of ownership interests that may be issued, LLC's are not subject to any of these restrictions. In addition, S corporations generally may not hold more than eighty percent (80%) of the total voting power and total value of another corporation's stock unless certain conditions have been satisfied with respect to wholly-owned subsidiaries. LLCs are not subject to this restriction. Furthermore, unlike LLCs, S corporations are not permitted to specially allocate income, gain, deduction, or loss among their shareholders or make disproportionate distributions to their shareholders. Finally, S corporations are subject to certain penalty taxes for built-in gains and excessive passive income that do not apply to LLCs.

On the nontax side, LLCs are attractive in that they are not subject to the same formalities as corporations, such as the requirements for calling and conducting meetings, and annually electing directors and officers. The rights, duties, privileges, and preferences of an LLC’s members are usually defined in the operating agreement, which is not a publicly filed document. Although amendments to the articles of incorporation of a corporation that may adversely affect one or more classes of stock generally require approval of at least a majority of all shareholders, amendments to an LLC’s operating agreement may generally be done without a separate class vote unless specifically required in the operating agreement.

Although LLCs enjoy significant advantages over corporations, members of an LLC treated as a partnership for tax purposes will not enjoy all the advantages of the numerous fringe benefits available to shareholder-employees of a C corporation. For example, the members may not receive tax free life insurance and medical benefits; may not participate in a cafeteria plan established for the LLC’s employees; and will find significant restrictions with respect to qualified retirement plans (e.g., inability to borrow from the retirement plan). Members of an LLC may also be subject to higher marginal tax rates than corresponding corporate tax rates.

The most important distinction between LLCs and general partnerships is that the partners of a general partnership are personally liable for the debts of the general partnership whereas the members of an LLC generally have limited liability. Partners acting in the ordinary course of business may bind the general partnership. However, a member who is not acting as a manager has no power to bind a manager managed LLC in transactions with third parties. Finally, a general partner in a general partnership may cause the dissolution of the general partnership when no definite term or particular undertaking is specified. A member of an LLC does not have any such right.
The striking distinction between LLCs and limited partnerships is that while every limited partnership must have at least one general partner who is potentially liable for all the obligations of the partnership, all members of an LLC have limited liability regardless of their participation in the management of the business. Although this problem can usually be resolved through the use of a corporate general partner, this increases the organizational complexity and administrative and compliance costs. Moreover, despite changes in state limited partnership statutes that permit greater participation in management by limited partners, limited partners may jeopardize their limited liability status if they actively participate in the business of the limited partnership.

While an LLC makes sense if the founders expect to operate the business on their own for a significant period of time before additional owners—employees and/or outside investors—are brought into the picture, a corporation may be the preferred choice when it is clear that support from outside investors will be needed fairly quickly and that those investors will require that the company be operated in the corporate form. Fortunately, state business entity laws have been reformed and modernized in recent years to allow for conversion of one form of entity into another with a minimum of regulatory paperwork as long as the economic interests of the owners remain essentially the same after the conversion has been completed.

Table 4
Advantages and Disadvantages of Limited Liability Companies

<table>
<thead>
<tr>
<th>Advantages:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. All members enjoy limited liability.</td>
</tr>
<tr>
<td>2. No limitation on the number or types of members.</td>
</tr>
<tr>
<td>3. Centralized management is available if an LLC is manager managed.</td>
</tr>
<tr>
<td>4. Assuming LLC is taxed as a partnership (see above), business profits are subject to only one tax, at the individual member level, and are not subject to double tax as would be the case if the profits were realized by a C corporation.</td>
</tr>
<tr>
<td>5. Losses are available on the members’ personal income tax returns and can offset other income (subject to the “at risk” and passive loss rules).</td>
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<td>6. Special allocations may be made for income tax purposes.</td>
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<td>2. Qualification is required for doing business in other states.</td>
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<tr>
<td>3. Regular reporting to governmental entities is required.</td>
</tr>
<tr>
<td>4. Termination results from the death, disability, or withdrawal of a member under the laws of some states.</td>
</tr>
<tr>
<td>5. Interests are not freely transferable.</td>
</tr>
<tr>
<td>6. Business profits are taxed as income to the individual members and, as a result, may be subject to self-employment tax as well as income tax.</td>
</tr>
<tr>
<td>7. Transfer of interests may be subject to securities law regulation.</td>
</tr>
</tbody>
</table>
§11 Factors in selecting the form of business entity

The process of selecting the form of business entity begins with the collection and analysis of information about each of the members of the founding group and the proposed business itself. With regard to each of the founders it is important to understand their present business occupation, business background and experience, marital status and related agreements, estate planning arrangements and overall financial condition. As for the proposed business it is necessary to have a good understanding of the proposed products or services, the inventions involved in the proposed business, the proposed management structure for the business, production and distribution plans, market conditions, the potential liabilities associated with the proposed business and the manner in which the founders propose to balance profitability and social responsibility and the impact of the business on stakeholders other than investors. Of course, it is also important to identify the business and personal objectives of each of the founders with respect to the proposed business activities.

The founders should meet with their professional advisors—attorneys and accountants—to learn about the various non-tax forms of business organization and the forms of business organization that are recognized under the tax laws and go over the advantages and disadvantages, both tax and non-tax, of conducting a business using each of the entities described above. Once they understand the available options the founders must then work with their professional advisors to go through a fairly extensive list of basic questions to make the best choice with regard to selecting the form of business entity:

- How is the business going to be capitalized and financed and what, if any, tax considerations are expected to arise in the course of developing the capital structure? Consideration should be given to the availability and sufficiency of the personal financial assets of the founders and the need to access outside sources of capital.

- How are the founders going to be compensated for their activities in connection with the business (e.g., salaries and/or distributions of revenue generated by the business) and what, if any, tax considerations arise in the course of developing the compensation structure? Consideration should be given not only to compensation arrangements for the founders but also the desire to offer attractive and flexible compensation programs to new managers and employees.

- What additional tax factors might influence the formation and operation of the business, including specific types of taxable income and expenses, the personal income tax situation of each of the founders and their preferences regarding “pass through” of income and losses for tax purposes, and the ease of converting to another form of entity?

- On what terms, if any, may ownership interests be transferred among the various founders or to third parties? Will ownership interests be important for recruiting and retaining other members of the management team and/or key employees?

- How will day-to-day operations be managed and what relationship is to exist between operational control and ownership of the business?
• Are there concerns that the activities of the business will result in personal liability to the founders in excess of the amounts actually contributed to the business? If so, what steps should be taken to limit the liability of the founders and what special agreements might be needed with respect to allocation of the risks and liabilities associated with the business among the founders?

• What fiduciary or contractual obligations are to exist among the founders?

• What understanding exists among the founders with regard to the duration of the business, the effect of the withdrawal of one or more of the founders and the dissolution or termination of the business?

• What costs and formalities are associated with the formation and maintenance of the particular form of entity, including any reporting or recordkeeping requirements?

• What, if any, legal requirements exist regarding the type of business which might be conducted by the entity?

• What provisions are to be made for the resolution of disputes and deadlocks relating to management of the business?

• What additional legal issues need to be addressed in connection with the formation of the business, including issues with respect to securities laws, labor laws, intellectual property rights, real estate laws, estate planning and compliance with various licensing and regulatory requirements?

• Do the founders intend to focus on activities that are intended to have a public benefit and, if so, should this dictate careful consideration of a nonprofit organization or a benefit corporation?

In order to properly resolve all of these questions, an analysis must be done of the various statutory, judicial, regulatory, commercial, contractual, financial and tax considerations that might be relevant to the resolution of the specific issue. From a tax perspective, care attention needs to be paid to taxation of income and losses and compensation arrangements. The earnings from business operations of an entity treated as a partnership for tax purposes (e.g., general and limited partnerships and LLCs unless they elect to be treated as a corporation for tax purposes) are taxed only at the owner level in the period in which the earnings occur. S corporations also allow earnings to be taxed only to the owners, although there are certain exceptions to this general rule which do not apply to proprietorships and partnerships. In contrast, the earnings from business operations of C corporations are subject to “double taxation,” once at the entity level when the earnings occur and again at the owner level when the earnings which remain after the corporate tax are distributed to the shareholders in the form of dividends. In the case of small businesses operated as C corporations, an effort can be made to minimize the effect of the double tax by paying pre-tax dollars to the employee-shareholders as salaries, thereby permitting the corporation to deduct the amounts that are paid prior to computation of the amount of tax at the corporate level. In contrast, any dividends paid are generally not deductible at the entity level.

Losses and other tax items from the operation of businesses conducted as partnerships for tax purposes or as an S corporation are “passed through” to the owners for use on their individual tax returns, subject to limitations on the use of losses beyond the owner's
“basis” in the ownership interest. Moreover, in general, the partnership form is preferable to the S corporation primarily because: (1) it is easier to obtain “basis” in a partnership than in a S corporation, thereby increasing the available deductions; and (2) partnerships are permitted to make special allocations of the losses and other tax items generated by the business which may not correspond to the basic allocation of profits, subject to the “substantial economic effect” test. In contrast, losses and other tax items from C corporations must be retained at the entity level and cannot be used by the shareholders on their individual tax returns. This treatment generally parallels the imposition of tax at the entity level for C corporations. C corporations may apply losses against past and future income in some cases.

Compensation refers to a broad number of factors, including salaries, bonuses and options for those stakeholders actively involved in the operation of the enterprise (e.g., founders, managers and employees), interest payments for debt holders of the enterprise, dividend payments for equity holders of the enterprise and the amounts received upon any sale or disposition of the stakeholder's interest in the enterprise. As the amounts available for compensation are dependent upon the financial performance of the business conducted by the enterprise, consideration must be given to the effect of the tax laws upon the funds and resources available for compensation as well as the tax effect to the enterprise and the recipient of a particular form of distribution. The range of benefits and compensation available for the employees of the business is generally greater in the corporate form. Certain employee benefits, such as health insurance and pension and profit-sharing arrangements, can be offered to the employees of a corporation on a tax-preferred basis. Moreover, the corporation permits the business to offer compensation in the form of ownership interests, either through stock purchases or options, without significantly impairing the ongoing management control of the business in the hands of the founders. It should be noted that use of an S corporation may limit the deductibility of certain fringe benefits. For example, medical reimbursements, disability retirement benefits, premiums on group term life insurance, and cafeteria plans paid to a stockholder holding a two percent or greater interest in the corporation are taxable to the shareholder but not deductible by the corporation.

There are times when the “real world” dictates how things get resolved with regard to the selection of entity. For example, the requirements of the business with respect to raising capital from outside the founder group, and the expectations of any outside capital providers with regard to sharing in the income and value appreciation associated with the business, will have a significant impact on the choice of entity. Investors interested in certain types of projects, such as real estate, prefer the flexibility that partnerships and LLCs offer in terms of allocating the interests of participants in the profits of the underlying business and permitting distributions in a manner that could not be made under corporate statutes relating to dividends and similar payments. On the other hand, if the founders anticipate seeking venture capital funding it usually means using the C corporation structure preferred by those types of investors. If the founders are planning on offering equity interests in the entity as an incentive to recruit managers and key employees they will probably be drawn toward use of a C corporation; however, they will protect their rights to manage and control the business by limiting the number of shares.
issued to persons outside the founding group and requiring that such persons agree to restrictions on their voting rights. If the founders are intent on pursuing social responsibility with the same intensity as profitability, the legal limitations associated with a traditional corporation needs to be considered and it may be more appropriate to select a benefit corporation.

There may a good deal of variation in the administrative complexity and expense associated with the choice and use of a particular form of business entity. As a general rule, a general partnership is generally the easiest form of business entity to create and operate, while limited partnerships, LLCs and corporations require compliance with a number of statutory requirements. However, general partnerships may require complex partnership agreements and each business form requires adequate accounting and financial reporting records. Formation and maintenance costs are a function of a number of variables including the amount of professional services needed to form the enterprise and document the contractual agreements among the founders, the degree of federal and state regulation of the business and the need to use other professionals, such as accountants and investment bankers, in connection with the operation of the business. In turn, the aforementioned variables are dependent upon the needs and objectives of the various participants. Thus, for example, the desire to have detailed periodic financial reports will necessarily increase the accounting costs associated with the business, and the additional reporting requirements for benefit corporations must also be considered before that entity is selected for the business. Also, complex outside financing arrangements may require the services of an investment banking firm, including the significant commissions associated with such an engagement.

§12 Selection process

In order to answer the questions listed above, the founders, typically working with experienced legal counsel, should collect business and financial information on the proposed business and each of the principals. If possible, a business plan and detailed projections should be prepared so that proper consideration can be given to specific risks and the forecasted amount and timing of profits and losses from the business. Once the information is collected, a good deal can be sorted out by asking several basic questions:

- Are there any nontax factors that would require utilizing the corporate form? These might apply when the business activities are particularly risky or the principals intended to raise significant amounts of capital from outside investors.
- Will the business generate losses during the early years of operation? If so, it probably makes sense to consider using one of the "pass-through" entities, such as a partnership, LLC or S Corporation.
- Are there any special tax planning considerations that must be taken into account? Anticipated transfers to family members for estate planning purposes may dictate the use of a limited partnership. If flexibility with employee benefits is desired, a corporation may be the best choice of entity. Of course, certain activities will be best suited for a nonprofit corporation that has qualified for exemption from taxation and can solicit contributions on a tax-friendly basis to the donor.

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• Are there any special nontax considerations that must be considered when no clear choice has emerged from the balance of the above referenced factors? Formation and administration costs are sometimes very important for small businesses. A focus on social responsibility may dictate consideration of a benefit corporation.

Even when a preliminary choice has been made based on the foregoing analysis, a variety of other issues must be considered, if not already taken into account. First of all, the participation of various types of entities, such as a corporation, a nonresident alien, or certain types of trusts, may prevent use of an S corporation, as may the number of participants. Second, participants who must be actively involved in managing the business must be general partners, members, or shareholders, with the choice depending upon the need for limitations on liability from the entity itself, rather than from insurance. The degree of involvement in the business may also impact the deductibility of losses for partners under the "passive activity" rules. Third, absent careful planning, transfers of ownership interests may result in a variety of adverse tax consequences when the partnership form is used. Also, planning for the withdrawal, retirement, or death of a principal may have an impact on the form of business entity selected. Fourth, the need to reinvest profits from the operation of the business may require using a C corporation, since the "pass-through" forms will tax the profits at the ownership level, thereby requiring that some distribution of assets be made to help the owners satisfy their current tax liabilities. Finally, if the principals are related to each other, any disproportionate relationship between the property and services contributed to the entity and the proprietary interests of the owners in the business may result in a reallocation of income between the parties if a partnership or an S corporation is used.

While the underlying assumption in this Guide has been that just one entity will be selected and used to operate the business, there is no rule against using more than one entity. For example, there may be situations where certain elements of the business should be separated, perhaps because of the disparate functional skills associated with the activity or the degree of potential liability. A decision might be made to separate manufacturing and sales activities into two corporations. Similarly, research and development activities might be conducted through the use of a limited partnership which provides tax benefits to outside investors while separating them from participation in the other activities of the business. A separate entity might also be formed to handle activities associated with a specific product line or to gain access to benefits for businesses organized in specific localities. The decision to use multiple entities must be balanced against the added complexities and other possible disadvantages. For example, multiple business entities can significantly increase administrative costs and create inefficiencies in production and marketing activities. The participants may be unable to use consolidated tax returns, thereby eliminating the ability to use the losses from one venture to offset the profits from another. Additional formalities must be observed when two or more entities are utilized, including the need for multiple qualifications in various states.

It is important for the founders to understand that while the initial selection of the form of entity is important, changes can be made as the needs of the business and its owners evolve over the life of the enterprise. State laws now allow for conversion of one form of
entity into another with a minimum of regulatory paperwork as long as the economic interests of the owners remain essentially the same after the conversion. For example, the founders may launch their new business in the form of an LLC in order to use losses during the early stages of the business to offset other income on their personal tax returns; however, when the business matures to the point where it begins to generate taxable income and the founders want to be able to offer equity interests to new managers and employees and raise capital from outside investors it will be time to convert the LLC into a C corporation. However, while changes can be made, certain changes may be more difficult than others: changes to and from benefit corporation status will require a supermajority vote and trigger appraisal rights.

§13 Special considerations for sustainable businesses

Sustainable entrepreneurs seek to integrate sustainable business practices into their operational activities.\(^{11}\) Sustainability does not mean conducting a business without concern for profitability, since profitability is necessary in order for the organization to continue in business and pursue its environmental and social purposes; however, many sustainable entrepreneurs want the freedom to consider the interests of multiple stakeholders, not just the stockholders, when making decisions about how to invest the resources of the organization. There is room for environmental and social responsibility in the activities of a traditional for-profit corporation—many corporations, large and small, have announced intentions to engage in “corporate social responsibility” in respond to market demands—but sustainable entrepreneurs seeking to make benefitting society the focal point of their businesses may need to consider alternatives to the traditional for-profit corporation, such as a nonprofit or benefit corporation.

Both traditional for-profit corporations and nonprofit corporations must have effective governance, talented and experienced leadership, formal strategic planning processes, quality products and services for their customers/constituencies, competent and committed personnel and cost-effective operations. A sustainable entrepreneur may wish to consider a nonprofit corporation in instances where the intended purpose of the business is to pursue a specific charitable, educational, literary, scientific or religious purpose, and the sustainable entrepreneur is reasonably comfortable that he or she will be able to gain access to the necessary capital through donations, grants and the sale of mission-related products and services as opposed to the traditional financial markets. The sustainable entrepreneur, as well as other managers and employees of the business, must also be content with a relatively modest level of compensation. Nonprofit corporations are also subject to rigorous and extensive disclosure requirements. See the table below for a comparison of traditional for-profit and nonprofit corporations.\(^{12}\)

\(^{11}\) For further discussion of sustainable entrepreneurship, see “Sustainable Entrepreneurship” in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

\(^{12}\) For further discussion of nonprofit corporations, see “Nonprofit Corporations” in “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
### Comparison of Traditional For-Profit and Nonprofit Corporations

<table>
<thead>
<tr>
<th></th>
<th>Traditional For-Profit Corporations</th>
<th>Nonprofit Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Owned by stockholders; assets are to be used for the benefit of the owners and must be distributed to the owners upon the dissolution of the corporation</td>
<td>Owned by the public, rather than any private person; assets of the nonprofit are irrevocably dedicated to the charitable, educational, literary, scientific or religious purposes of the nonprofit</td>
</tr>
<tr>
<td>Purpose; Measures of Success</td>
<td>Generate money for the owners; success is profitability</td>
<td>Serve the public; success is meeting the needs of the public; profitability is necessary only to the extent that it allows the nonprofit to survive</td>
</tr>
<tr>
<td>Board Members</td>
<td>Board members are usually paid; board members owe a fiduciary duty to the owners of the corporation to maximize the value of the owners’ interest</td>
<td>Board members are usually unpaid volunteers; duty of the board is to ensure that the nonprofit fulfills its purpose</td>
</tr>
<tr>
<td>Management Compensation</td>
<td>Managers can make sizable income</td>
<td>Managers should make reasonable, not excessive, income</td>
</tr>
<tr>
<td>Use of Surpluses</td>
<td>Money earned over and above what is needed to cover expenses is retained as profits and distributed to the owners, thereby allowing the owners to earn a profit on their investment if the business of the corporation is successful</td>
<td>Money earned over and above what is need to cover expenses is retained as surplus (i.e., no private person benefits financially from the financial success of the nonprofit) and should be spent over the short-term on meeting needs of the public (nonprofits can earn profits from activities not directly to the nonprofit’s mission; however, substantial profits will be taxed)</td>
</tr>
<tr>
<td>Executive Leadership</td>
<td>The CEO is usually a member of the board of directors and often serves as the chairperson of the board</td>
<td>The CEO, often called the Executive Director, typically does not serve as a member of the board of directors</td>
</tr>
<tr>
<td>Accountability</td>
<td>Reporting and disclosure obligations vary depending on whether the corporation is “public” or “private”; large corporations must file detailed reports on a quarterly and annual basis with the federal Securities and Exchange Commission including financial statements and information regarding the business and governance practices of the corporation; disclosure requirements for private corporations are</td>
<td>Nonprofits are responsible to the public and must file annual information returns with federal and state governments that are available to the public and include detailed information regarding finances and executive compensation</td>
</tr>
<tr>
<td>Category</td>
<td>Description</td>
<td>Exception</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Taxation of Entity</td>
<td>Usually not exempt from paying federal, state and local taxes</td>
<td>Can be exempt from federal taxes, and some state and local taxes, if the nonprofit applies for and is granted tax-exempt status from appropriate governmental agencies upon proof that strict conditions for such status have been satisfied; tax-exempt status depends on the adherence of the nonprofit to its stated purpose</td>
</tr>
<tr>
<td>Taxation of Capital Providers</td>
<td>Money invested in for-profit corporations usually cannot be deducted from investor’s personal tax liability; profits realized by owners may be taxed at favorable rates</td>
<td>Money donated to a nonprofit can be deducted from the donor’s personal tax liability if the nonprofit was granted charitable status from the appropriate governmental agency</td>
</tr>
<tr>
<td>Raising Capital</td>
<td>Capital may be raised from the sale of ownership interests (i.e., stock), borrowing from private lenders; and commercial loans and owners may contribute cash, property or services in exchange for the interests</td>
<td>Nonprofits depend primarily on donations, grants and purpose-related earning income (i.e., from the sale of memberships and/or products or services) to fund operations</td>
</tr>
<tr>
<td>Attracting Employees</td>
<td>Employees may be recruited by offering attractive cash compensation and benefits as well as by offerings of equity stakes in the business that would allow them to shares in the profits generated by the business</td>
<td>Nonprofits have fewer resources than for-profit corporation with respect to recruiting talented employees and cannot offer the same level of cash compensation, nor can they offer equity interests in the business</td>
</tr>
<tr>
<td>Sustainability</td>
<td>Primary fiduciary duty of directors and officers is to create long-term value for the owners of the corporation and sustainability-related initiatives will only be permitted to the extent that they do not interfere with the corporation’s profitability and enhancement of stockholder value; benefit corporations do allow for consideration of interests of multiple stakeholders</td>
<td>Nonprofits are explicitly formed to pursue public benefit purposes and their status as a nonprofit depends on ensuring that their resources are devoted to socially oriented activities; nonprofits do not answer to owners, but instead must report to the constituencies that provide resources and who are the intended beneficiaries of the nonprofit’s activities; regulators also monitor the activities of the nonprofit to make sure they meet the criteria for being a public benefit</td>
</tr>
</tbody>
</table>

**Source:** Adapted from “Field Guide to Developing, Operating and Restoring Your Nonprofit Board” prepared by Authenticity Consulting LLC, https://managementhelp.org/misc/Nonprofits-ForProfits.pdf
While nonprofit corporations clearly allow a sustainable entrepreneur to “do well for the world” they also place constraints on the entrepreneur’s ability to raise significant amounts of investment capital. In addition, a sustainable entrepreneur often feels that his or her idea can simultaneously improve society and generate profits that can be used to provide a reasonable return to investors and rewards to those who choose to work in the business. Unfortunately, as discussed above, the law remains fairly clear that a traditional for-profit corporation must be carried on primarily for the profit of stockholders and board members cannot shape and conduct the affairs of the corporation for the merely incidental benefit of stockholder and for the primary purpose of benefiting others constituencies. As such, a sustainable entrepreneur seeking to recognize and balance the interests of investors, the protection of the environment and social responsibility must carefully consider operating his or her mission and business through a benefit corporation governed by new statutes that allow such a corporation to operate in a responsible and sustainable manner as a means for not only maximizing stockholder value but also providing benefits to society in general. See the table below for a comparison of traditional for-profit and benefit corporations.13

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Traditional For-Profit Corporation</th>
<th>Benefit Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A corporation is generally set up strictly for profit-making business purposes and maximizing income and equity value The primary, some would say sole, purpose of the traditional for-profit corporation is to create value for its shareholders.</td>
<td>In addition to pursuit shareholder value in the same way as a traditional for-profit corporation, a benefit corporation may be formed for the purpose of creating general public benefit, defined as a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard that satisfies certain requirements. In other words, a benefit corporation must operate as a “triple bottom line” business by considering its impact on the community and the environment, taken as a whole, along with generating profits for its shareholders. Pursuit of shareholder value and profitability is necessary in order for the corporation to survive; however, investors are asked to accept only a reasonable and competitive return on their investment. The ability to pursue profitability is a primary difference between a benefit corporation and a nonprofit.</td>
</tr>
</tbody>
</table>

13 For further discussion of benefit corporations, see “Benefit Corporations” in “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
<table>
<thead>
<tr>
<th>Governance</th>
<th>Directors have a fiduciary duty to manage the corporation in the best interests of the shareholders, which means that they generally only consider the profits and equity value of the corporation’s shareholders.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency</td>
<td>Shareholders have limited rights to inspect the corporation’s books and records. Corporations subject to the reporting requirements of the Securities and Exchange Commission must file detailed reports including financial statement and information on the business and governance practices of the corporation, which reports are available to the public. Private corporations may be contractually obligated to provide reports to their shareholders. Traditional corporations are generally under no obligation to provide reports or information to non-shareholders, save for reporting obligations to governmental agencies in certain instances.</td>
</tr>
<tr>
<td>Accountability</td>
<td>Stockholders can sue for breach of fiduciary duties, generally for failure to maximize economic return for shareholders.</td>
</tr>
<tr>
<td></td>
<td>Directors must consider and balance the interests of chosen constituencies other than shareholders that are affected by the company’s conduct (e.g. employees, local community, the environment). Directors must ensure that the corporation acts in a responsible and sustainable manner, which means that the directors must be prepared to engage in a continuing process of determining who is materially affected by the corporation’s business, developing and maintaining criteria for balancing both the interests of those so effected, as well as any specific benefit identified in the corporation’s charter, and measuring progress against those criteria. Depending on the state in which the corporation is organized, assessment of the progress of the corporation may need to be made against one or more third party standards.</td>
</tr>
<tr>
<td></td>
<td>The corporation must report on its overall social and environmental performance to shareholders, and in some jurisdictions, to the public. Reports must include the sustainability objectives established by the board; standards adopted to measure progress in promoting those objectives; factual information based on those standards regarding the corporation’s success in meeting the standards; and an assessment of the corporation’s success in meeting the standards.</td>
</tr>
<tr>
<td></td>
<td>In addition to standard shareholder rights, shareholders can sue to enforce the company’s public benefit mission. In some states, stakeholders affected by the corporation’s conduct can also sue to enforce the corporation’s public benefit mission.</td>
</tr>
</tbody>
</table>
### Advantages and Disadvantages for Sustainable Entrepreneurship

| Relative certainty regarding legal framework and access to large pool of potential capital providers; however, emphasis on primary obligations to maximizing shareholder value makes it difficult to implement sustainability initiatives unless it can be shown that they clearly contribute to enhancing shareholder value |

The governance principles applicable to benefit corporations are similar to those for traditional for-profit corporations, but benefit corporations allow sustainable entrepreneurs to pursue profitability and providing a greater good for the public and addressing the interests of non-investor stakeholders, provide more freedom to the entrepreneur by not requiring that the corporation be operated solely to maximize shareholder value and make it more difficult for future leaders to dilute the sustainability focus of the initial founders; however, benefit corporations are subject to extensive reporting obligations, will likely have more difficulty in raising capital and will have to operate within a relatively untested legal framework until case law clarifies fundamental concepts such as balancing profitability and providing a public benefit.


## §14 State of incorporation

Assuming that the founders decide to use a corporation, either Subchapter S or Subchapter C, as the legal entity for their new business, consideration should then be given to the state law under which the corporation will be formed, organized and operated. The choice of "governing law" will obviously impact the analysis of statutory laws and judicial interpretations, since substantial variations exist from state to state with respect to statutory content and the depth and quality of the underlying case law. While the easiest way to proceed is to incorporate under the laws of the state in which the founders reside and the principal business activities of the company will be conducted the founders can actually choose any state provided that they have legal and tax advisors who can assist them in fulfilling the applicable legal requirements.

The common practice for emerging companies, regardless of where they have set up their headquarters, is to incorporate in Delaware since the corporate laws of that state are generally considered to be sophisticated, comprehensive and well defined. In fact, venture capitalists, a primary source of funding for emerging companies, typically prefer Delaware since they are familiar with applicable law and believe that Delaware law provides greater clarity regarding the fiduciary duties of directors and the rules governing mergers and acquisitions. In addition, Delaware courts have recognized and upheld
broad indemnification rights and limitations on liability for directors of Delaware corporations, an important factor once the corporation has completed an IPO and the actions of directors are subject to scrutiny and attack by public investors.

The advantages of incorporating in Delaware are greatest for publicly-traded corporations and some companies incorporate initially under the law of the state where their principal headquarters are located and then change their state of incorporation to Delaware immediately prior to their IPO; however, reincorporation can be more expensive than operating as a Delaware corporation from the outset. Founders should be aware that choosing a foreign jurisdiction for the formation and organization of their new corporation may not always be effective in avoiding the application of local laws. For example, companies with more than half of their business and shareholders in California that elect to incorporate in Delaware may nonetheless be governed by California corporate law principles prior to their IPO by virtue of the application of California Corporations Code § 2115. Incorporating outside of the state where the company’s primary business activities will be conducted may also result in added expense due to the costs of operating as a foreign corporation and the need to engage local counsel in the state in which the entity is incorporated.

If the founders select an LLC for their initial form of business entity they will also need to decide on the state in which the LLC will be formed. As with corporations, the founders may select any state, regardless of where they will actually be conducting their business activities, and founders of an emerging company are well advised to choose a state with LLC laws that are flexible enough to permit the use of creating management structures and support operations in multiple states. Not surprisingly, Delaware is also a popular and preferred state for formation of LLCs because statutory provisions are based on freedom of contract principles and the courts have substantial experience in defining and applying LLC law.

When the decision is made to form and organize the business as a benefit corporation, several different statutory frameworks are available and should be considered. In general, state benefit corporation statutes address three major areas: corporate purpose (i.e., creating a material positive impact on society and the environment); accountability (i.e. expanded fiduciary duties of directors that extend beyond shareholders to include consideration of non-financial interests); and transparency (i.e., an obligation to report on its overall social and environmental performance as assessed against a comprehensive, credible, independent and transparent third-party standard). However, every state is different and it is important to understand the approaches taken in states with statutes based on the Model Benefit Corporation Legislation and in the statutes that have been adopted in California and Delaware. See the table below for a comparison of the benefit corporation statutes in California and Delaware.\footnote{For further discussion of benefit corporations, see “Benefit Corporations” in “Governance: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).}
Benefit Corporations: California versus Delaware

While sustainable entrepreneurs often decide to incorporate their businesses under the laws of the state in which the principal operations of the company will occur, it is possible to incorporate under the laws of another jurisdiction if those laws are perceived as being better suited to the goals and resources of the sustainable entrepreneur. For example, a California-based sustainable entrepreneur might consider whether to incorporate under California’s own benefit corporation statute or under the provisions of the Delaware General Corporation Law pertaining to “public benefit corporations” and in so doing will review the following key differences between California and Delaware law:

- California requires that the enterprise provide general public benefit (“a material positive impact on society and the environment taken as a whole”) and also permits, but does not require, enterprises to specify a specific public benefit, such as improving human health. Delaware requires enterprises to provide a general and a specific public benefit.
- In discharging their respective duties, and in considering the best interests of the benefit corporation, the board of directors, committees of the board, and individual directors of a California benefit corporation are required to consider the impacts of any action or proposed action upon all of the following: (1) the shareholders of the benefit corporation; (2) the employees and workforce of the benefit corporation and its subsidiaries and suppliers; (3) the interests of customers of the benefit corporation as beneficiaries of the general or specific public benefit purposes of the benefit corporation; (4) community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located; (5) the local and global environment; (6) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by retaining control of the benefit corporation rather than selling or transferring control to another entity; and (7) the ability of the benefit corporation to accomplish its general, and any specific, public benefit purpose. Directors of a Delaware benefit corporation are required to manage or direct the business and affairs of the corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.
- California requires an annual benefit report to shareholders which must be distributed and posted on the enterprise’s website within 120 days of the end of each fiscal year. Delaware requires a biennial statement to the shareholders; however, most frequent reporting may be required in the certificate of incorporation.
- California requires that an evaluation of benefit purpose must be done based on an independent third party standard. In contrast, Delaware law permits an internal assessment, although a biennial statement must specify the standards and criteria used for assessment. A third party standard may be required if the requirement is included in the certificate of incorporation. For example, the certificate of incorporation might provide that the corporation will prepare, deliver and post its public benefit statement annually and prepare it in accordance with a third party standard for defining, reporting and assessing a corporation’s social and environmental performance meeting certain criteria laid out in the certificate (e.g., it assesses the effective of the business and its operations on the interests of those materially affect by the corporation’s conduct; it is developed by an organization that is independent of the corporation or its affiliates; and it has information publicly available regarding the criteria and weighting used to assess performance, the process by which the standard is developed and the independence of the organization that developed the standard).
- In California a two thirds vote of shareholders is required to change general or specific purpose or merge existing business into a benefit corporation. A two thirds vote requirement for changing general or specific purposes also applies in Delaware; however, Delaware law requires a 90% vote of outstanding shares to merger an existing business into a benefit corporation.
- In California, any shareholder may bring a derivative action in a benefit enforcement proceeding to require enterprise to pursue public benefit purposes or to assess or issue a benefit report; however, no money damages are available, but reimbursement of fees and expenses incurred in connection with the
proceeding is available. In Delaware, only shareholders who hold individually or collectively at least 2% of the outstanding shares are allowed to bring a derivative action for breach of duties owned by the board of directors to “balance the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of incorporation”.


§15 When to form the new legal entity

Every successful company begins with an idea for a new product or service or an improvement or enhancement to an existing product or service that can be executed without infringing the legal rights of firms that are already in the market. The path from an idea to a business can take many routes and it takes time and effort to shape and test the idea and turn it into a concrete plan to develop the product or service and execute the marketing, manufacturing and sales strategies necessary for commercial launch. Much of the activity associated with this very early-stage development is informal and it may not yet be clear who will join, and remain with, the team that will ultimately launch the business. In fact, there will usually be times when the founders have serious doubts as to whether a business will ever get off the ground and it is not surprising that the founders may be reluctant to consider incurring the costs, and investing the time, necessary to form a legal entity (e.g., an LLC or a corporation) that would be used to conduct the business and regulate the activities and relationships of the founders. Among other things, forming a company means confronting sensitive issues such as allocation of ownership interests and managerial responsibilities and the irrevocable transfer of individual legal rights to elements of the idea to the company. While these concerns are understandable there are nonetheless several important legal, tax and business advantages to early formation of a company.

§16 Limited liability for principals of the business

From a legal perspective the main reason for forming an LLC or a corporation is to provide limited liability for the founders. Until a formal entity is formed the prospective founders are considered to be acting in their individual capacities when engaging in activities relating to the fledgling business and, as such, may be held personally liable for any debts or other legal obligations to third parties arising out of those activities. In fact, if the founders are deemed to be partners of one another than they would be personally liable for the actions of one another under agency principles. A member of an LLC or a shareholder of a corporation is generally not liable for the debts and liabilities of the business conducted by the entity and the potential loss of the member or shareholder is capped at the amount of his or her investment in exchange for membership interests or shares. There are costs associated with forming and organizing these entities, and
members and shareholders must comply with certain formalities—maintenance of separate records and accounts, conduct of business through formal owner and management board actions, and execution of contracts in the name of the entity—to rebut any claim that the entity is merely a sham; however, it is generally worth it manage and limit the financial risks associated with the venture. Of course, the founders may nonetheless be required to offer some or all of their personal assets as security for the company’s performance of its obligations to third parties. For example, a bank or other commercial lender may be unwilling to extend credit to the company without personal guarantees from the founders since the company has yet to accumulate a substantial amount of its own cash and other assets that the lender can look to for collateral.

§17 --Tax considerations

Tax considerations also point to early formation of the company for several reasons. First of all, by forming the company early the founders can proceed with the issuance of membership interests or shares and thus get the clock ticking on the holding period for capital gains treatment upon a subsequent sale of the ownership interests. Once the founders have held their ownership interests for one year they would be entitled to have any gain on the sale of those interests taxed at the long-term capital gains rate while gains on sales that occur within the first year after acquisition would be taxed at the individual’s ordinary income tax rate which will typically be much higher than the long-term capital gains rate. Obviously it is uncommon for the founders to sell their ownership interests within the first year or two after formation of the company, since significant appreciation in the value of the interests does not occur until much later; however, there may be situations where a product or technology is so attractive to an outside party that it is willing to make a substantial offer before development and commercial launch has occurred.

Another tax advantage of issuing ownership interests as soon as possible is the ability of the founders to set a lower purchase price for the interests and successfully defend the modest valuation of the business against subsequent challenges by the IRS seeking to tax the founders on deemed compensation associated with their receipt of “cheap stock” (i.e., paying less than fair market value for the membership interests or shares). To illustrate the problem assume that the founders intended to work for six to 12 months on the development of their new idea and then approach outside investors to raise $2,000,000 to fund completion of the initial product and commercial launch. Also assume that the founders anticipate that, if all goes well, they will need to surrender 50% of the equity of the company in exchange for the funding, which means that the “pre-money” valuation of the founders’ equity interests would be $2,000,000. Finally, assume that a corporation is to be formed and that the injection of cash from the outside investors occurs through the issuance of 2,000,000 shares of Series A Preferred Stock priced at $1.00 per share and that the founders would hold 2,000,000 shares of Common Stock at the time of the closing of the investor deal. Both the founders and the investors expect and understand that the primary contribution of the founders is the intangible value of the ideas, and related technology, that they have created for the business and it is not expected that the founders would pay more than a nominal amount (e.g., $0.01 per share) for their shares.
However, if the founders wait until just before the outside financing to receive their shares the IRS may argue that the $0.01 purchase price was significantly below the then fair market value of the shares in light of nearly contemporaneous sale to the investors at $1.00 per share and that the founders had compensation income, taxable at ordinary income tax rates, of $0.99 per share--$1.00 per share paid by the investors less the $0.01 per share paid by the founders). The safer course for the founders is to form the corporation, and issue shares to themselves at $0.01 per share, well in advance of the time when a commitment is received from investors to finance the company at a particular valuation. The founders can then argue that there was no higher outside valuation of the company at the time their shares were issued and can also point out that the lower valuation was warranted because of the risks associated with the company and that the fact that investors would not have been willing to assign a higher valuation to the company until a number of technical and business milestones were achieved.

§18 --Consummation of key contracts and development of brand identity

Formation of a separate legal entity as soon as possible also facilitates the negotiation and consummation of key contracts with outside parties and early development of a separate brand identity for the business. While the core working group for the new venture will usually be kept quite small, often no larger than the team of founders, help and support from third parties with specialized expertise and assets (e.g., facilities and equipment) will be needed as soon as possible and the terms and conditions of the business arrangements with these parties will need to be memorialized in written contracts. For example, the founders may need help from software developers and engineers to complete a prototype of the new product and will want to enter into independent contractor or consulting agreements with those persons. In order to avoid the complexity of personal liability for the founders it is important to form a legal entity that can be the contracting party. Also, by forming a new company with a distinctive name and logo the founders can begin to send a message to the relevant marketplace regarding their intent to compete and offer an innovative product, service or technology. Even if the founders lack the funding and time to mount a full marketing program they can selectively begin to build name recognition at trade shows, conferences and through participation in Web logs and online social networking sites.

§19 --Legal and psychological impact on the founders

A final, and absolutely critical, element of the formation of a new company is the irrevocable decision of the members of the founding team to surrender to the company their individual claims to the core legal rights associated with the particular product, service or technology. Typically when the company is formed the founders will execute technology assignment agreements in favor of the company, including assignments of patents and copyrights that allow the company to file registration applications in its own name, in exchange for the ownership interests in the company and will also enter into employment agreements that include an acknowledgement from the founders that all intellectual property rights they develop while employed by the company belong to the company. In addition, the founders will agree to restrictions on engaging in competitive
activities during their employment. The bottom line is that from the time the company is formed the only way that the founders can realize the fruits of their innovation is through the success of the company and therefore before taking this step each of the founders must care evaluate whether they can remain committed to the business and whether they can work closely and smoothly with all the other members of the founding team. Unfortunately, since relations between the founders may sour in the future, or outside investors may dictate that one or more of the members of the founding team be removed from day-to-day involvement with the company, it is prudent to plan in advance for a withdrawal of a founder. In most cases all or a portion of the ownership interests issued to a founder will be subject to “vesting” and the company and/or the other founders would have the right to repurchased unvested shares at their original cost to the departing founder if the founder leaves the company prior to a specified date or because of a breach of his or her obligations to the company.

§20 Formation and organization procedures

Once the appropriate form of business entity has been selected, the founders, typically with the assistance of counsel, must proceed with completing the documents and filings necessary to adequately form and organize the entity. For example, in the case of a general business corporation, articles of incorporation and bylaws will need to be prepared along with any shareholders’ or other ancillary agreements and the articles of incorporation must be properly filed with the secretary of state in the state in which the corporation is to be incorporated. Specific procedures must also be followed to establish a general partnership, limited partnership or limited liability company. Special situation entities may raise unique issues, as when the business that will be formed and organized is a close corporation, a professional corporation, a nonprofit corporation or a professional services or limited liability partnership.

Once the entity has been formed, the attorney for the business should schedule an organizational meeting among the founders to complete any other legal matters that may be required for the particular form of entity and to establish a routine that will insure that the founders continue to observe the formalities that may be associated with the formation and operation of the particular type of legal entity (e.g., in the case of a corporation, decisions must be made through properly conducted board and shareholders’

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15 For detailed discussion of the basic steps to be taken to form and organize a new general business corporation or a new benefit corporation, see “Formation and Organization of Corporations” and “Formation and Organization of Benefit Corporations”, each of which can be found in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
16 For detailed discussion of the basic steps to be taken to form and organize a new limited liability company, see “Formation and Organization of Limited Liability Companies” in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
17 For detailed discussion of the basic steps to be taken to form and organize a new nonprofit corporation, see “Formation and Organization of Nonprofit Corporations” in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
meetings and actions). Organizational actions include the initial sales and issuance of ownership interests, designation and appointment of officers and authorization of the initial contracts for the business (e.g., leases and employment agreements) and the opening of bank accounts. The organizational meeting is also a good time and place to finalize and execute the various agreements among the members of the founding group relating to their rights to participate in management of the business and restrictions on their ability to transfer their ownership interests. Clear records should be maintained of actions taken by the board of directors or other management group.
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 80 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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