

From Concept to Company - The Covid Edition by David Goldenberg

We are in a time of disruption, but we can and will make it through. A few thoughts on this time and structures for forming a new business.

I thought I would start this month with some broader thoughts and commentary. Talking about indemnity clauses right now just didn't seem to fit. And yet, regardless of what happens with the health crisis, figuring out a way to adjust our business (and worrying about things like indemnity clauses) is exactly what we need to do. Like many of you, I have had many moments these last few weeks where I have pondered where this will all lead.

While every major event seems unprecedented, looking at this unique point, where we have interconnection on a historically unprecedented level, and an event which has completely upended so many disparate sectors of our economy, it is hard to see exactly how this will play out.

That being said, from the little corner where we sit, advising founders, investors, growth companies and medium-sized businesses, it is clear that while things will not likely resemble the life we had for a while, the engines, resources, resourcefulness and other tools that have created so much success over the last decades are all still here. Investors have money. While the ones we have spoken with are certainly more cautious about where it is going to get spent, people generally recognize that there will be new opportunities created by this pandemic, and want to help. There are new problems to solve, but they are certainly not unsolvable. At the same time, if your business has been disrupted, waiting for someone else to solve the problem does not look to be a great business strategy in this time.

A buzzword in the tech community is 'first principles thinking.' This concept is loosely that people often try to solve problems by analogy to current solutions, or base a solution on false assumptions. Breaking a problem down in a new way often leads to radical new solutions. One of my favorite examples of this was Elon Musk as he pondered how to build a spaceship. As the **story goes**, he interviewed all the best people in the field and came up with a range of prices, which were very high. However, instead of accepting that answer, he asked 'what is the cost of the atoms that make up a spaceship?' which was orders of magnitude less than the quotes he had received. He went back to each of these people and asked why those atoms could not be arranged in the shape of a rocket ship for less than they had quoted,

and SpaceX was launched.

Every month, we are contacted by new founders wanting to create a business. Often this desire comes from a dream they have for themselves or their community, an opportunity they see where they feel they can make a unique contribution. Those calls have not stopped. For those of you who cannot see a path forward for your current business, think of how you can use the tools, parts, skills and resources your business has in a new way.

If you do decide to start a new business, the legal structure of your business is one of the most important decisions you'll make before going to market.

This is for two reasons:

- ➔ Tax purposes
- ➔ Liability for debts and lawsuits

To minimize the amount of taxes paid by a successful business and its founders, a company can be organized as a 'pass-through' entity (meaning that the entity itself is disregarded for most income tax purposes, although some other business taxes such as franchise tax and sales tax may apply depending on the state you're operating in).

Pass-through companies include sole proprietorships, partnerships, limited liability corporations, and S-corporations. These are all structured slightly differently, but in each the entity generally pays no taxes on profits and passes those profits on to the business owners for tax purposes.

Each of these business structures has certain advantages and disadvantages. With sole proprietorships (businesses owned by an individual) and partnerships (business owned by multiple people), the owners will be completely liable for any debts and lawsuits that come their way as a result of their business. This could potentially mean the repossession of their home or personal items outside of the business. However, these business structures are often easy to set up and have lower fixed costs.

With limited liability companies (LLCs), business owners are taxed as individuals but if properly structured, the company (not the owner) is liable for debts and lawsuits. An S-corporation has a similar tax and liability structure, although it does have more limitations on ownership. The ownership of these two types of businesses is also easier to transfer than it is for sole proprietorships and partnerships. In a sole proprietorship or partnership, it is often difficult or impossible to transfer licenses, permits, tax IDs, and bank accounts.

What is a C Corporation?

A C-corporation is the main alternative to the 'pass-through' structures described above. Here, it is the business that is taxed on the company's profits, not the owners. The C-corporation also shields the owners from individual liability for debts and lawsuits. There are many reasons why people choose a C-corporation for their business, and for many business purposes, they are the only available choice.

What to Do Once you've Chosen your Business Structure

An experienced business lawyer will be in a great position to advise on the best business structure for your needs. Once this has been decided, you'll be ready to register your business name with the state. You'll also need to obtain a business license to operate in your state, and you'll typically want a tax ID from the IRS.

I hope everyone out there is staying safe. It is hard to think about business or anything else when your health or the health of your loved ones is at risk. But once those basic needs are met, let's get to work on solving the new problems we face, on making our businesses more resilient, on creating a future where we can thrive in our new normal.