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HOW TO CHOOSE A BUSINESS STRUCTURE: A Decision Guide

Wholesome Wave, Conservation Law Foundation, & CLF Ventures | October 2014

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Wholesome Wave works to direct capital and business development assistance to local food system infrastructure businesses that are critical to making healthy local food accessible and building robust farm communities. In our work with new and growing local food enterprises which often struggle to balance mission and margin goals, many enterprises, have had questions about how to structure their entities – Should I be for-profit? Nonprofit? Cooperative? To help address these questions, we worked with Conservation Law Foundation and CLF Ventures to develop a how-to guide for local food enterprises approaching this important decision about their business structure.

At Conservation Law Foundation and CLF Ventures, we believe that healthy communities and a clean environment are rights for all New Englanders, not a privilege of the few. Our work since 1966 has focused on actively protecting all parts of New England’s environment, including everything from oceans to river to mountains, from parks to forests, from big cities to small towns, from Maine to Rhode Island. Every day, we use the law, science, and the market to develop innovative, pragmatic solutions to New England’s toughest challenges, in order to make New England a better place to live, work, and play for everyone.

Using a practical and well-researched approach, CLF and CLF Ventures developed How To Choose a Business Structure as a decision guide. While it does not replace good legal counsel, this Guide sets a framework to help entrepreneurs understand how different business structures can impact their criteria and goals. Though we initially intended to create a guide specifically for local food enterprises, the information and themes proved to be universal, and so we offer this industry-agnostic guide. Small businesses everywhere of every type will benefit from CLF’s analysis of the benefits and challenges of each business structure option.

None of this important and meaningful work would be possible without our valued partners and funders – we are grateful for their support and wisdom.

We hope that this decision guide is of great value to you.



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HOW TO CHOOSE A BUSINESS STRUCTURE: A Decision Guide

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About CLF Ventures

CLF Ventures is the nonprofit consulting affiliate of Conservation Law Foundation, New England's leading regional environmental advocacy organization. CLF Ventures works with corporate, government, and nonprofit clients to cultivate a thriving economy that is environmentally and socially sustainable. We navigate complex technological and environmental problems involving a diversity of stakeholders, where good process is critical and significant values are at stake. For more information, visit <http://www.clfventures.org>.

About Conservation Law Foundation

Since 1966, Conservation Law Foundation has used the law, science, policymaking, and the business market to find pragmatic, innovative solutions to New England's toughest environmental problems. Whether that means cleaning up Boston Harbor, protecting ocean fisheries to ensure continued supply, stopping unnecessary highway construction in scenic areas, or expanding access to public transportation, we are driven to make all of New England a better place to live, work, and play. What's more, we have the toughness to hold polluters accountable, and the tenacity to see complex challenges through to their conclusion. CLF is also nimble enough to adjust course as conditions change to achieve the best outcomes. Our goal is not to preserve what used to be, but to create an even better New England – a region that's truly thriving. For more information visit, <http://www.clf.org>.

About Wholesome Wave

Wholesome Wave is a national 501(c)(3) organization that is helping to reshape the American food system by putting entrepreneurial, innovative thinking to work. Our organization partners with farmers, farmers markets, community leaders, healthcare providers, like-minded nonprofits, and government entities to implement programs that increase affordability and access to healthy, locally grown fruits and vegetables for consumers in underserved communities. We operate by partnering with community-embedded organizations to implement our programs, including our Double Value Coupon Program, the Fruit and Vegetable Prescription Program® and Healthy Food Commerce Investments. Wholesome Wave programming is now in 28 states and the District of Columbia with more than 60 partners at nearly 400 participating farm-to-retail venues. For more information, visit <http://www.wholesomewave.org>.

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Legal disclaimer: Wholesome Wave, CLF Ventures, and Conservation Law Foundation are not responsible for the outcome of any decision made using this guide nor for the consequences of any investment made based on such a decision.

INTRODUCTION

The legal structure, or legal business form, of an organization impacts its operation, purpose, management and control, capital investment opportunities, growth potential, risk and liability exposure, and taxation. Organizations need a solid business structure in order to thrive. Understanding the basics of currently available business forms is important to enable organizations to launch and continue successful operations. The goal of this Guide is to help individuals starting or operating businesses gain a working knowledge of the legal business structures available to them.

For worksheets and other tools that accompany this Decision Guide, please visit <http://www.wholesomewave.org/our-initiatives/healthy-food-commerce-investments/>

IMPORTANT NOTICE: Individuals are strongly encouraged to consult with a qualified attorney and accountant before choosing a business form or changing business forms. Information contained in this report is not intended to be legal or tax advice. CLF Ventures and Wholesome Wave are prohibited from practicing law. Consult appropriate professionals before making any legal or tax-related decisions.

HOW TO USE THIS GUIDE

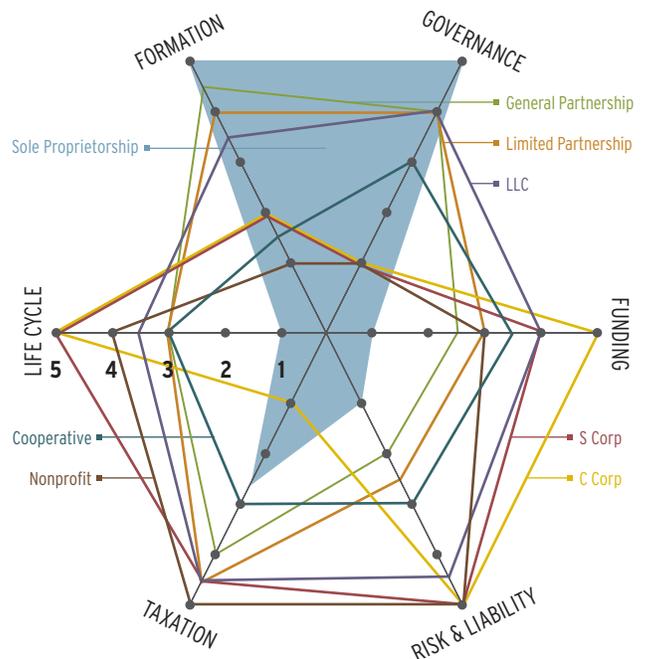
Part 1 outlines the basics of each business form. Reference this part for general background information on business structures.

Part 2 discusses important decisions you should consider carefully before choosing your organizational structure.

Keep in mind that there is no perfect business form. What form works best depends largely on the unique circumstances of your organization. Prospective and current business owners should look to this Guide as a starting point for determining what form to take. The Guide provides basic but crucial business form information that every organization should consider before delving too deeply into operations. At the end of the Guide is a list of resources for further assistance and research, particularly for food-related businesses.

A note on radar charts:

At the start of each business form section, you will find a chart like the one below. The solid shape reflects the form being discussed in that section. The outlined shapes represent the seven other business forms discussed in this Guide. We have chosen to include all eight forms in each chart to illustrate how the metrics of that particular form compare to the other seven.



BUSINESS STRUCTURES

This part gives a broad overview of the common business forms. It discusses important factors that help determine the most successful structure for your organization:



1. Formation



2. Governance: Management and Control



3. Funding



4. Risk and Liability



5. Taxation



6. Life Cycle

For a quick guide to help answer questions you may have about business forms, refer to the tables on the following pages.

TABLE 1: BUSINESS ORGANIZATION FORMS OVERVIEW

	 FORMATION	 GOVERNANCE	 FUNDING	 RISK & LIABILITY	 TAXATION	 LIFE CYCLE						
RATING SCALE	1	Harder to form	1	Less control by founders	1	Fewer opportunities to raise capital	1	Less risk/liability protection	1	Fewer tax benefits	1	Less durable
	5	Easier to form	5	Greater control by founders	5	Greater opportunities to raise capital	5	Greater risk/liability protection	5	Greater tax benefits	5	More durable
SOLE PROPRIETORSHIP	5	<ul style="list-style-type: none"> Formed by default—an individual starting a business Simple to form 	5	<ul style="list-style-type: none"> Sole control Share profits 	1	<ul style="list-style-type: none"> Owner capital Fewer opportunities No liquidity 	1	<ul style="list-style-type: none"> Unlimited personal liability 	2.5	<ul style="list-style-type: none"> Pass through—only the individual is taxed 	1	<ul style="list-style-type: none"> Limited by owner
GENERAL PARTNERSHIP	4.5	<ul style="list-style-type: none"> Formed by association—two or more people starting a business Simple to form Draft agreement 	4	<ul style="list-style-type: none"> Equal/agent relationship among owners—partners are operators and agents of the business Partners control Share profits 	2.5	<ul style="list-style-type: none"> Partner capital No liquidity 	2	<ul style="list-style-type: none"> Unlimited personal liability (joint/several) 	4	<ul style="list-style-type: none"> Pass through—only the individual is taxed 	3	<ul style="list-style-type: none"> Limited by partners Change requires unanimity
LIMITED PARTNERSHIP	4	<ul style="list-style-type: none"> Association + filing (w/state) More costly than general partnership Draft agreement 	4	<ul style="list-style-type: none"> General partner = control; limited partner = no direct control Share profits 	3	<ul style="list-style-type: none"> Partner capital Liquidity for limited partners 	2.5	<ul style="list-style-type: none"> General partnership = Unlimited personal liability (joint/several) Limited partnership = Limited 	4.5	<ul style="list-style-type: none"> Pass through—only the individual is taxed 	3	<ul style="list-style-type: none"> Limited by partners Change requires majority
C CORPORATION	2	<ul style="list-style-type: none"> Filing (w/state) More work to form Draft articles of incorp./bylaws Appoint board 	1	<ul style="list-style-type: none"> Less direct control Board controls Dividends 	5	<ul style="list-style-type: none"> Greater opportunities—debt/equity (shares) Liquidity 	5	<ul style="list-style-type: none"> Limited 	1	<ul style="list-style-type: none"> Double—corporate entity taxed and owners taxed 	5	<ul style="list-style-type: none"> Perpetual Change requires majority
S CORPORATION	2	<ul style="list-style-type: none"> Filing (w/state) + elect to be “S Corp” More work to form Draft articles of incorp./bylaws Appoint board 	1	<ul style="list-style-type: none"> Less direct control Board controls Dividends/salaries 	4	<ul style="list-style-type: none"> Greater opportunities—debt/equity (shares) Some liquidity 	5	<ul style="list-style-type: none"> Limited 	4.5	<ul style="list-style-type: none"> Pass through—only the individual is taxed 	5	<ul style="list-style-type: none"> Perpetual Change requires majority

TABLE 1: BUSINESS ORGANIZATION FORMS OVERVIEW

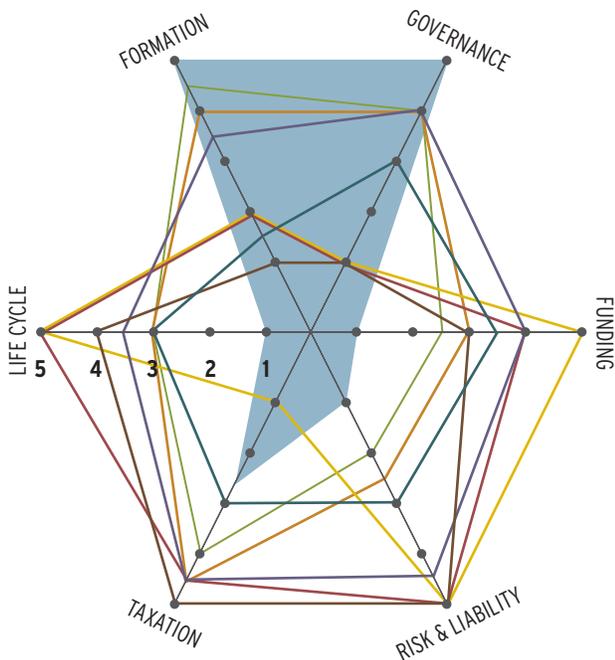
	 FORMATION	 GOVERNANCE	 FUNDING	 RISK & LIABILITY	 TAXATION	 LIFE CYCLE						
RATING SCALE	1	Harder to form	1	Less control by founders	1	Fewer opportunities to raise capital	1	Less risk/liability protection	1	Fewer tax benefits	1	Less durable
	5	Easier to form	5	Greater control by founders	5	Greater opportunities to raise capital	5	Greater risk/liability protection	5	Greater tax benefits	5	More durable
LLC	3.5	<ul style="list-style-type: none"> Filing (w/state) Easier to form than corporation Draft operating agreement 	4	<ul style="list-style-type: none"> Flexible control Equal/agent relationship among owners—partners are operators and agents of the business; or manager Equal distribution of profits 	4	<ul style="list-style-type: none"> Member capital No liquidity Debt/equity opportunities 	4.5	<ul style="list-style-type: none"> Limited 	4.5	<ul style="list-style-type: none"> Pass through—only the individual is taxed 	3.5	<ul style="list-style-type: none"> Determined by operating agreement Change requires majority
	1	<ul style="list-style-type: none"> Filing (w/fed & state) More work to form Draft bylaws Elect directors 	1	<ul style="list-style-type: none"> Less direct control Board controls Significant filing Compensation 	3	<ul style="list-style-type: none"> Limitations on profits More grant opportunities No liquidity 	5	<ul style="list-style-type: none"> Limited 	5	<ul style="list-style-type: none"> Tax free 	4	<ul style="list-style-type: none"> Perpetual Change requires majority
	1.5	<ul style="list-style-type: none"> More work to form Can incorporate or not 	3	<ul style="list-style-type: none"> Equal control Share profits 	3.5	<ul style="list-style-type: none"> Member capital Debt/equity opportunities (non-voting shares) Limits on profit distribution 	Variable	<ul style="list-style-type: none"> Depends on structure 	Variable	<ul style="list-style-type: none"> Depends on structure 	Variable	<ul style="list-style-type: none"> Depends on structure Change requires majority
COMPARISON	Sole Proprietorship	5	5	1	1	2.5	1					
	General Partnership	4.5	4	2.5	2	4	3					
	Limited Partnership	4	4	3	2.5	4.5	3					
	C Corporation	2	1	5	5	1	5					
	S Corporation	2	1	4	5	4.5	5					
	LLC	3.5	4	4	4.5	4.5	3.5					
	Nonprofit	1	1	3	5	5	4					
	Cooperative	1.5	3	3.5	Variable	Variable	Variable					

TABLE 2: BUSINESS ORGANIZATION FORMS: ADVANTAGES/DISADVANTAGES*

FORM	ADVANTAGES	DISADVANTAGES
SOLE PROPRIETORSHIP	<ul style="list-style-type: none"> FORMATION: formed by association GOVERNANCE: control; equal/agent  	<ul style="list-style-type: none"> FUNDING: lack of opportunities; lack of liquidity RISK & LIABILITY: unlimited personal liability LIFE CYCLE: dependent; change must be unanimous   
GENERAL PARTNERSHIP	<ul style="list-style-type: none"> FORMATION: formed by association GOVERNANCE: control; equal/agent TAXATION: pass through; flexible (but complicated)   	<ul style="list-style-type: none"> FUNDING: fewer opportunities; lack of liquidity RISK & LIABILITY: joint/several; personal LIFE CYCLE: dependent; change must be unanimous   
LIMITED PARTNERSHIP	<ul style="list-style-type: none"> GOVERNANCE: control—general partnership—yes; limited partnership—no RISK & LIABILITY: limited partnership—limited TAXATION: pass through; flexible (but complicated)   	<ul style="list-style-type: none"> FUNDING: more opportunity to raise capital RISK & LIABILITY: general partnership—joint/several  
C CORPORATION	<ul style="list-style-type: none"> FUNDING: more opportunity to raise capital RISK & LIABILITY: limited LIFE CYCLE: indefinite; change by majority   	<ul style="list-style-type: none"> FORMATION: filing GOVERNANCE: less control; board TAXATION: double   
S CORPORATION	<ul style="list-style-type: none"> FUNDING: more opportunity to raise capital RISK & LIABILITY: limited TAXATION: pass through LIFE CYCLE: indefinite; change by majority    	<ul style="list-style-type: none"> FORMATION: filing GOVERNANCE: less control; board  
LLC	<ul style="list-style-type: none"> FORMATION: easier for one person GOVERNANCE: control; equal/agent or manager FUNDING: more opportunity to raise capital RISK & LIABILITY: limited TAXATION: pass through     	<ul style="list-style-type: none"> FORMATION: harder for multiple people FUNDING: fewer opportunities than the corporate form  
NONPROFIT	<ul style="list-style-type: none"> RISK & LIABILITY: limited TAXATION: tax-exempt entity LIFE CYCLE: indefinite; change by majority   	<ul style="list-style-type: none"> FORMATION: filing GOVERNANCE: less control; board  
COOPERATIVE	<ul style="list-style-type: none"> FUNDING: more opportunities to raise capital 	<ul style="list-style-type: none"> FORMATION: can be difficult to reach agreement among members 

* What is an advantage/disadvantage may vary slightly depending on the unique circumstances of your business.

SOLE PROPRIETORSHIP



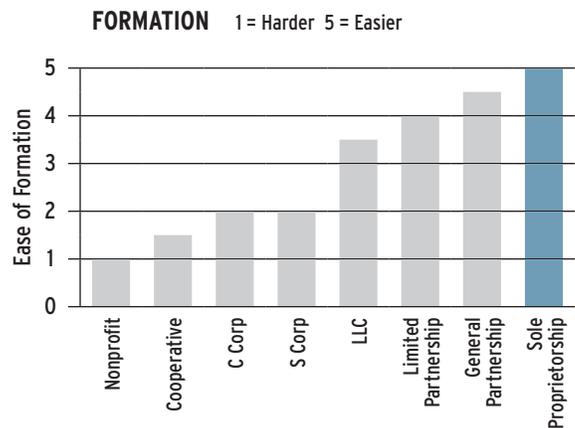
Overview

The sole proprietorship is the simplest business form and the easiest to start. This can make it an attractive choice for a new venture. But take care before choosing this structure. It does not offer many of the attendant benefits of the more complex business forms. Reaping some of those benefits can be particularly important given the often-intensive investment in infrastructure required in the early stages of starting a business. Nonetheless, a sole proprietorship comes with its own benefits and is worth consideration.

A sole proprietorship is a business owned by one individual. The proprietor and the business are the same. In other words, unlike a corporation, the business does not have a separate legal identity. **The business's income is the owner's income; the business's losses and liabilities are the owner's losses and liabilities.** Some of the qualities that make this structure attractive are the very same qualities that can make it a challenging choice for growing a successful business.

Formation

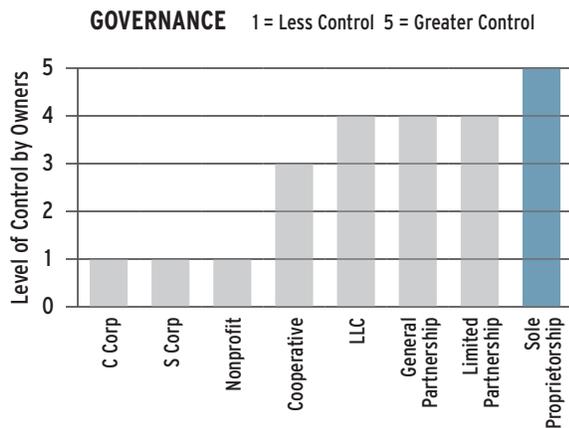
This is the simplest type of business to start because there are no formal requirements. If you are an individual who begins operating a business, your structure defaults to the sole proprietorship. Even so, you must register your business with the local government under the business's name – “doing business as.” You may also need to obtain licenses and permits relating to your operations, but this will be true for any organizational form. Know that, **while forming a sole proprietorship is easy, it may require significant personal capital, depending on the planned scale of your operation.**



Governance: Management and Operation

A sole proprietorship gives you tremendous control over your business. With that freedom comes tremendous responsibility for decision-making. Because there are no specific statutory obligations (such as having a board, officers, or set meetings), **an owner of a sole proprietorship possesses great flexibility in conducting the operations.** You decide who gets hired and fired; you decide your organizational goals; you can make all the day-to-day decisions. As the owner, you can choose to be solely responsible for management. Likewise, however, you are solely responsible for actions of those who may work for you.

No accounting requirements exist, aside from reporting income for tax purposes. In fact, though not advisable, owners are legally permitted to commingle business and personal funds.



Funding

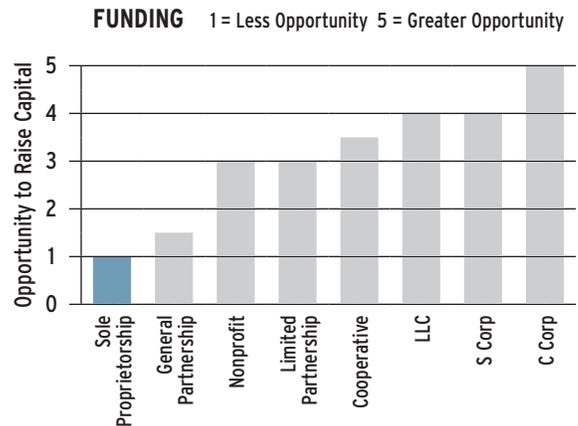
The ability to fund your business as a sole proprietorship presents one of the two biggest challenges to this organizational structure. **A sole proprietorship's equity capital is determined – and limited – by the wealth of the owner.** Because the business is not a separate entity recognized by the state, it cannot take loans or make contracts in its own name. A loan to the business must be a loan to the owner. You, the owner, may have to put up much or all of the initial capital. Obtaining a loan may be possible depending on your financial circumstances. But, as discussed below, creditors can access an owner's personal funds to satisfy debt.

As a for-profit, a sole proprietorship will also have more difficulty accessing alternative forms of financing, such as state or federal grants or low-interest loans.

A sole proprietorship has no shares or shareholders. The business is sold by conveying its assets, which can be cumbersome. To be transferred, each category of assets requires its own documentation and execution, and likely the consent of third parties to the transfer. If you take on equity investors – individuals who will share in the profits of the business – the sole proprietorship will default to a general partnership (see Partnership below).

Overall, if you are well capitalized as an owner, or if the way you plan to structure your organization is not capital intensive, at least in the startup phase, the funding challenge for a sole proprietorship may not outweigh the control you gain may outweigh the funding challenges

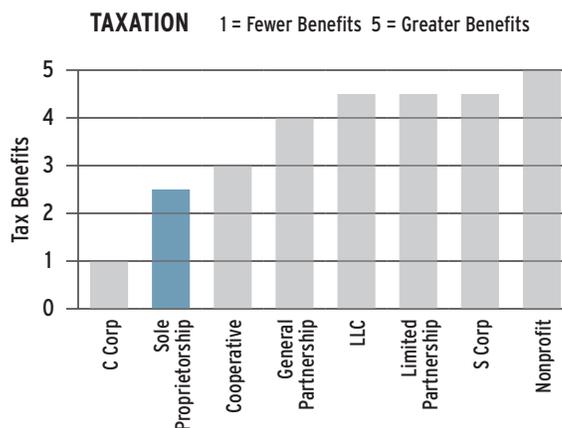
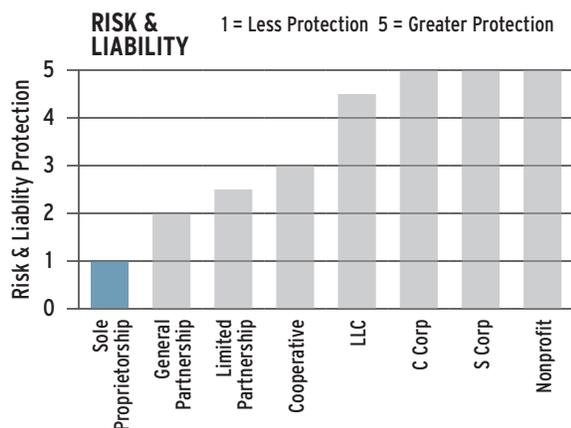
with this business structure. For many businesses requiring a capital-intensive infrastructure to get off the ground, however, this business form might prove challenging.



Risk and Liability

The risk of personal liability presents the other major challenge to sole proprietorships. **Though insurance can limit liability to some degree, owners are liable personally for any debt the business accrues.** That means creditors could seize the owner's personal assets to satisfy unpaid debt. Moreover, if the business has employees, or if someone acts as an agent of the business (i.e., performs a service at the business's direction), the business owner may be personally liable for wrongs committed by those employees or agents. Any judgment against the business from a lawsuit or civil penalty is assessed against the owner personally.

The ability to access an owner's personal assets to satisfy a liability could make investing in a sole proprietorship attractive to some lenders. However, it also means that investing in a sole proprietorship may involve more risk than a lender is willing to accept. A business may face risk management issues for a variety of reasons. Thus, you should think carefully about how much risk – and potential liability – you are willing to accept before choosing this business form.



Taxation

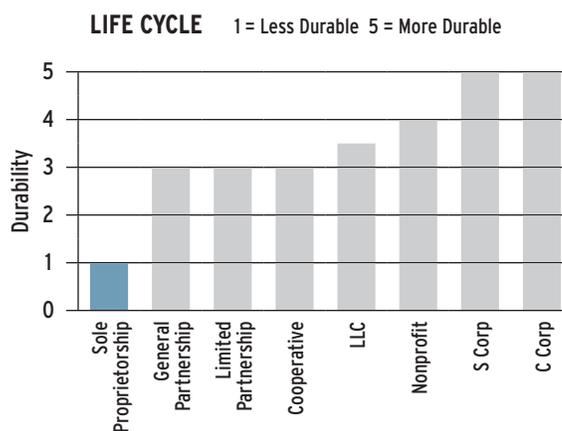
Because a sole proprietorship does not have an identity separate from the owner, it is not taxed separately. In other words, the company does not pay income taxes of its own. **Income of the business is treated as income of the owner.** The business operates under the social security number of the owner. A separate tax return is not required for the sole proprietorship. All income and losses are reported on Schedule C on the owner's individual income tax return.

Note that, under federal tax law, all income classified as "self-employment income" is subject to the self-employment tax, though you can deduct the employer-equivalent portion of your self-employment tax in figuring your adjusted gross income. This deduction affects only your income tax, not the self-employment tax or your net earnings from self-employment.

If the business has employees, it will need to get a federal employer identification number (EIN) for tax withholding purposes. It may also need to pay into certain programs for its employees. A major concern of the Internal Revenue Service (IRS) in auditing sole proprietorships is that the business may deduct individual personal expenses that are not business related, and that the business may not report income. **Proper accounting, as with any business form, is important to running a successful sole proprietorship.**

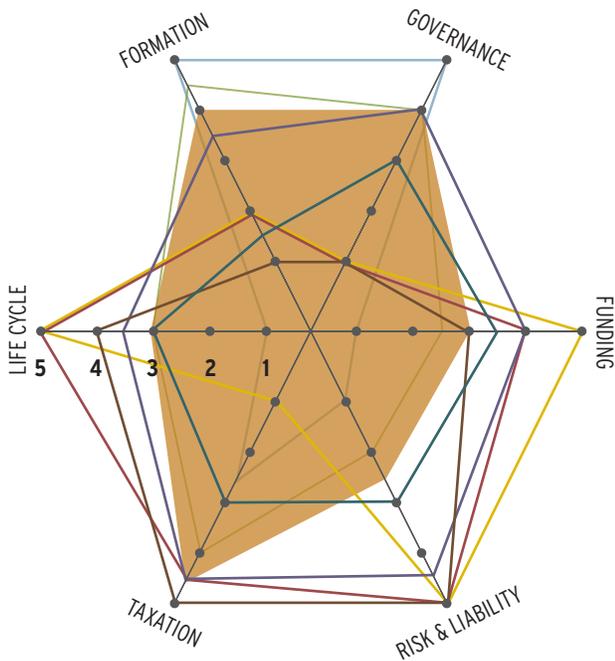
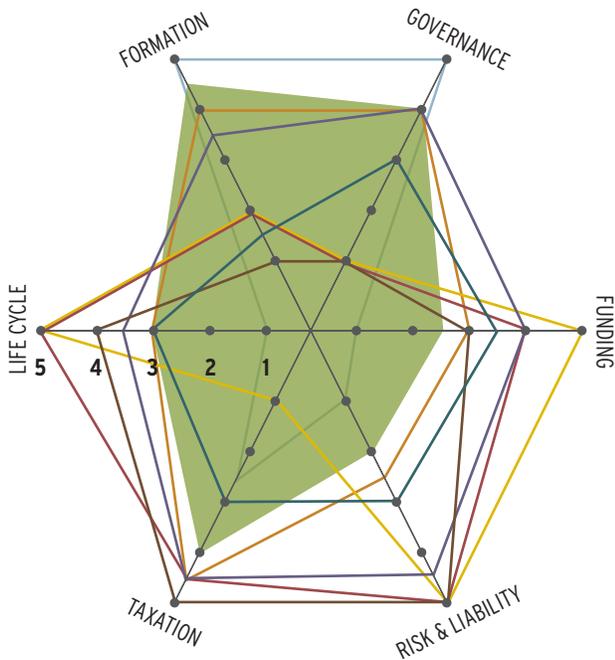
Life Cycle

A sole proprietorship does not have an identity separate from its owner. Therefore, **unless its assets and name are acquired by, or transferred to, a different person, the business dies with its owner.** The business may be intimately linked to the identity and personality of its owner, which can be beneficial. But it can also prove challenging if you want the business to continue beyond an individual owner. Because there are no formal requirements for winding down a sole proprietorship, you bear the responsibility for planning carefully what will happen to your business assets and liabilities over the lifespan of the company.



GENERAL PARTNERSHIP

LIMITED PARTNERSHIP



Overview

The partnership form overcomes many of the sole proprietorship's limitations, but also comes with its own drawbacks. A partnership involves both contract and statute. If two or more persons start a business without any other formalities, by law they will likely default into a partnership. Though a partnership is the aggregate of its partners – similar to a sole proprietorship not being distinct from its owner – it is also in some ways considered its own entity. This gives the partnership some advantages over a sole proprietorship, such as more financial protection for the individual partners, and the ability to continue more smoothly beyond the departure or death of the constituent partners. While there are many variations on partnerships, the two main types are general partnerships and limited partnerships.

General partnerships used to be the norm for the partnership form. **Under a general partnership, each partner is liable for all debts and obligations of the partnership.** Today, forming a limited liability partnership (LLP), or a limited liability limited partnership (LLLLP) for a limited partnership, should be strongly considered instead, because these forms limit the personal liability of the individual partners. There are several reasons why individuals may form a non-limited liability partnership, including regulatory barriers, lack of knowledge about limited liability options, or perceived flexibility in structuring the business. But given the relative ease of creating limited liability, you should consult with a lawyer and strongly consider forming an LLP or an LLLL. General partnerships and limited partnerships are discussed below because they form the backbone of understanding how partnerships work. Reference to LLPs and LLLLs are made where appropriate.

Formation

GENERAL PARTNERSHIP

A general partnership forms when two or more persons agree to operate a business and share profits. It can be as simple as a handshake or involve complex arrangements. Before forming a general partnership, you should draft a general partnership agreement that establishes at least the following:

- Each partner's ownership interest
- How profits and losses are shared
- Any obligation to contribute additional capital
- How management and control is shared among the parties and how decisions are made
- The ability to incur debt or other liabilities for the partnership
- Restrictions on transferring partnership interests
- The process to accept new partners and the process for a partner to withdraw from the partnership and the process to dissolve the partnership

You should not enter into a general partnership without clearly understanding and establishing the liability risk, the investment obligations, and the management structure. It is strongly advised to consult with an attorney when drafting the partnership agreement.

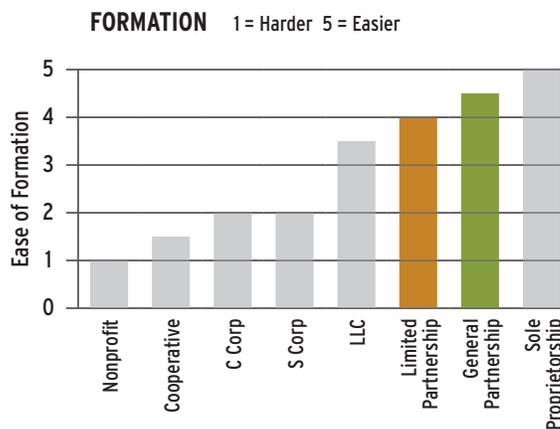
Know that every state has a statute that does the following:

- Determines whether a partnership exists
- Governs the relationship of the partnership and its partners with third parties (outsiders)
- Subject to the partnership agreement, governs the relationship among the partners and between the partners and the partnership
- Determines when a partnership no longer exists and what happens to each partner's interest and the partnership's assets and liabilities

LIMITED PARTNERSHIP

A limited partnership limits the liability of the partners. It still has a general partner who can be held personally liable. But this partner is typically an entity such as a limited liability company in order to keep liability from flowing to the individual owners. The limited partners can be individuals or entities. A limited partnership is

a state-created entity, which means you must file a certificate of formation to form a limited partnership. You will also need to draft a Limited Partnership Agreement. These formalities, and the reality that the general partner is usually an entity, are reasons why **the startup cost for a limited partnership is typically greater than for a general partnership.**



Governance: Management and Operation

GENERAL PARTNERSHIP

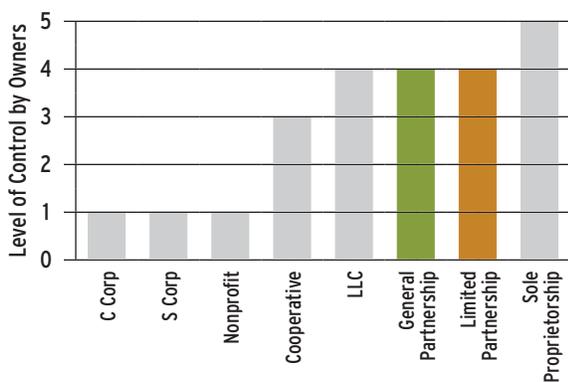
The partnership, like the sole proprietorship, offers significant flexibility in controlling the operations of the business. Because a partnership involves more than one person, additional attention must be given to structuring control of the organization. As explained above, the written partnership agreement sets forth the governance structure of the partnership. Draft this agreement carefully. If it does not cover certain aspects of the partnership, state law fills in the gaps by default.

Partners run the day-to-day operations of the business. They can, however, divide up responsibilities as they see fit. Partners typically receive a pro rata share of profits. But given the partnership form's flexibility, you may structure both profit and loss distribution in a different manner. Though taking on new partners typically requires unanimity among existing partners, a partner's ownership stake in the partnership can be bought or sold.

LIMITED PARTNERSHIP

The general partner of a limited partnership controls the day-to-day operations. If a limited partner exhibits control over the company, that person risks being held personally liable for obligations. However, a limited partner can control the company's operations as an employee and still be protected by limited liability. The limited partnership provides significant flexibility in governance structure. A general partner could even have no financial stake in the company yet exert complete control. This business form's flexibility and limited liability may make it a more attractive choice than a general partnership. Nonetheless, limited liability structures for general partnerships – LLPs – and limited partnerships – LLLPs – are often more attractive than the straight limited partnership.

GOVERNANCE 1 = Less Control 5 = Greater Control



Funding

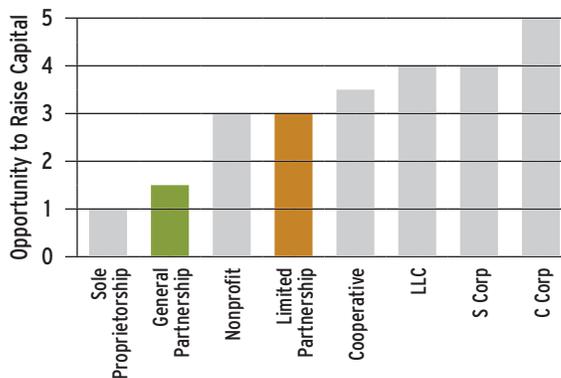
GENERAL PARTNERSHIP

The partnership form offers greater capacity to raise capital than the sole proprietorship. It is not limited by the wealth of a single owner. A partnership has several means of raising money. It can take debt under the partnership itself, individual partners can invest money in the business, the partnership can take on additional partners, and it can raise funds through its business operations. Your equity investors, however, will be general partners. Overall, the power to raise capital in a partnership gives this business form an advantage over the sole proprietorship.

LIMITED PARTNERSHIP

A limited partnership can raise capital similar to a general partnership. The difference is that **the ability to take on limited partners may increase this form's equity investors**, because those individuals may become partners of the entity without risk of personal liability.

FUNDING 1 = Less Opportunity 5 = Greater Opportunity



Risk and Liability

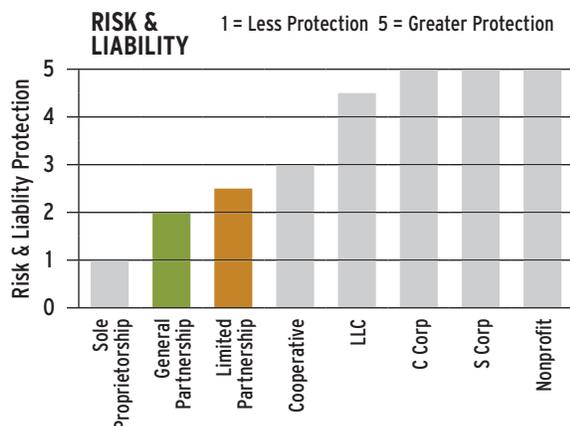
GENERAL PARTNERSHIP

As with the sole proprietorship, exposure to personal liability that accompanies the general partnership is the greatest drawback to this business form. In a general partnership, each partner exerts control over the company but also acts as an agent of the partnership itself – acts on behalf of the partnership. **The risk in the general partnership structure is that each partner can be held jointly and severally liable for debts and obligations of the partnership.** This means that a creditor or someone injured by the partnership, or injured by a partner acting on behalf of the partnership, could pursue any partner for satisfaction of the entire debt or obligation. The partnership agreement allows partners flexibility in assigning risk among each other. But state law determines the structure of liability between the partnership and third parties. To avoid this liability risk, you should strongly consider an LLP instead of a simple general partnership structure.

LIMITED PARTNERSHIP

As its name indicates, **a limited partnership provides greater liability protection, but only for the limited partners.** The general partner of a limited partnership is still open to personal liability for debts and obligations.

To limit liability, you should consider an LLLP type of limited partnership.



Taxation

GENERAL PARTNERSHIP

The partnership can be an attractive form because of the somewhat flexible, though also somewhat complicated, tax structure. Partnerships are taxed under the partnership tax rules located in subchapter K of the Internal Revenue Code. LLCs, LPs, and LLPs are also taxed under these partnership tax rules unless the LLC, LP, or LLP has expressly elected with the IRS to be taxed as either a C Corporation or an S Corporation. A partnership, LLC, LP, or LLP wishing to be taxed as either a C Corporation or an S Corporation would make that election on IRS Form 8832. The following discussion of the tax treatment of partnerships generally applies to LLCs, LPs, and LLPs unless they have elected S Corporation or C Corporation tax status.

The profits and losses of the partnership flow through to the partners based upon the profit and loss sharing ratio established in the partnership agreement.

Though this once made the general partnership an attractive business structure, businesses can now receive this “pass-through” taxation with LLPs and LLCs, while also receiving the limited liability protection of those business forms and the benefit of partnership taxation under subchapter K. Subject to some restrictions in the Tax Code, partnership agreements (as well as LLC, LP,

and LLP agreements) can be drafted to call for allocations of profits and/or losses that are non-pro rata with respect to the partners’ underlying interest in the partnership. For example, a partnership agreement could be drafted so that each partner holds a 50 percent ownership interest in the partnership but one partner gets a larger percentage of certain distributions of profits or losses than the other partners. Such non-pro rata allocations are not available to owners of C Corporations or S Corporations (or partnerships, LLCs, LPs, or LLPs that have elected to be taxed as a C or an S Corporation).

Appreciated property owned by a partnership (or an LLC, LP, or LLP) can generally be distributed tax-free to a partner during the life of the partnership or upon its liquidation. Such distributions of appreciated property by C Corporations or S Corporations would generally result in tax. For example, if a partnership with three equal partners owned appreciated property, the partners could agree that the partnership would redeem the partnership interest of one partner in exchange for some, or all, of that appreciated property. Generally, neither the partnership nor any partner would incur tax on the redemption. Such a redemption by either a C Corporation or an S Corporation (or a partnership, LLC, LP, or LLP electing to be taxed as a C or an S Corporation) would generate tax. **The ability to move appreciated property into and out of partnerships (and LLCs, LLPs, and LPs) without generating a tax to either the partnership or its partners is a major tax advantage as compared to C and S Corporations.**

Also, any profits of the partnership flow through to the partners and are taxable to the partners, regardless of whether any cash is distributed. In practical effect this could result in partners being allocated income without receiving cash with which to pay the associated tax. A partnership can address this problem by including a cash distribution provision in the partnership agreement (or the LLC, LP, or LLP agreement) requiring the partnership to distribute any available cash, as necessary, to pay for taxes due on distributed profits.

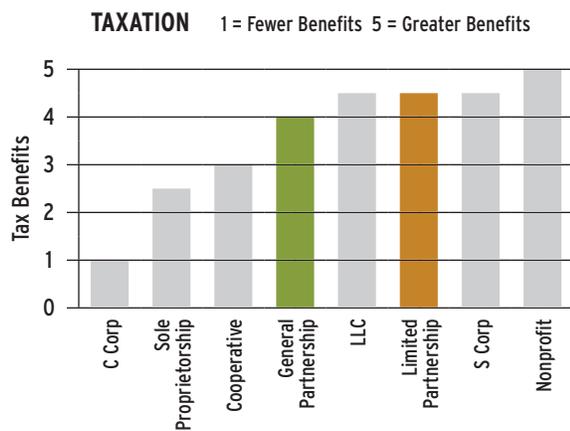
A general partner can deduct losses to the extent of her outside basis in her partnership interest, including her share of any debt in the partnership. This is a major advantage over an S Corporation, whose owners do

not get outside basis credit for their share of the S Corporation's liabilities. For this reason, **if a business is expecting to generate losses in the first few years of operation it may make sense for the business to be formed as a partnership (or more likely an LLC or LLP to receive liability protection)**. As with the proprietorship, income flowing to a partner is subject to the self-employment tax at the partner level if the partnership's income from operations qualifies as self-employment income.

Be aware that federal income tax law for partnerships is extremely complicated (as can be state tax law for partnerships). It offers significant flexibility, but also significant pitfalls for the unaware. You should coordinate with a tax attorney and a certified public accountant, and ensure your attorney and accountant coordinate as well.

LIMITED PARTNERSHIP

The limited partnership's tax consequences are similar to those of the general partnership, discussed in detail above. One advantage, however, is that income is not normally subject to self-employment tax. **The limited partnership offers many creative tax-planning designs.** Again, consulting with a tax lawyer and accountant is highly recommended.



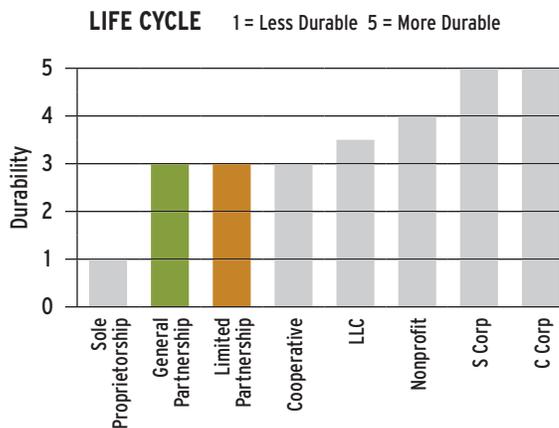
Life Cycle

GENERAL PARTNERSHIP & LIMITED PARTNERSHIP

Another advantage of the partnership form over the proprietorship is that a partner's economic stake in the partnership can be bought and sold. This means that **a partnership has the ability to continue indefinitely as new partners join the business.** The partnership ends with the death of the last general partner.

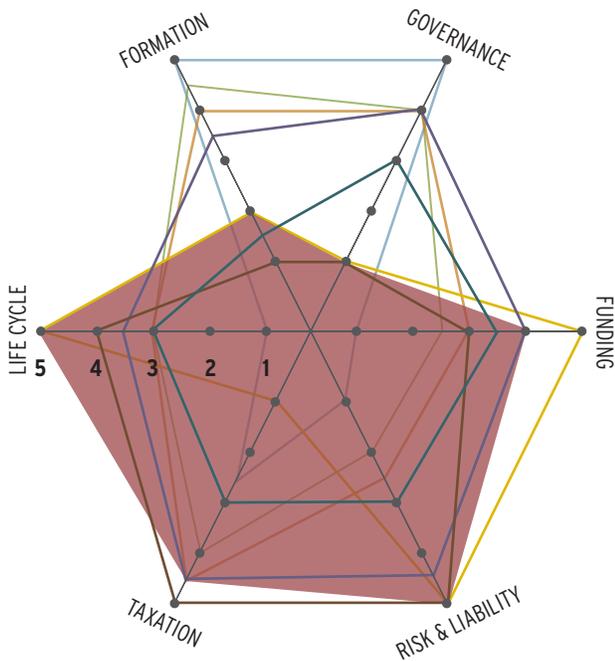
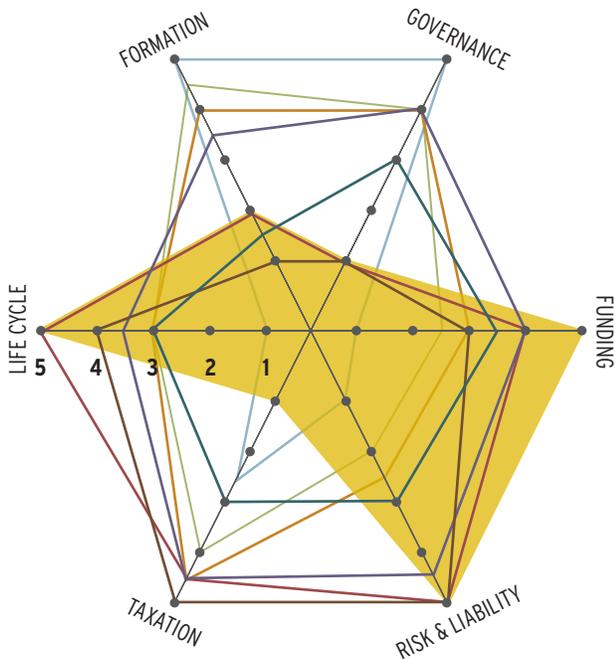
However, solely for tax purposes, a partnership (or LLC, LP, or LLP that is taxed as a partnership) will terminate solely for tax purposes if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in the partnership's capital and profits. Practically speaking, in the year of the transfer, this generally means that the partnership will file two tax returns: (1) one final year tax return, showing the termination of the partnership as of the effective date of the transfer; and (2) one initial, short-year tax return for the "new" partnership beginning on the day following the transfer.

Note that such a transfer of a majority interest in a partnership results in a termination of the partnership for tax purposes only. **The process of formally ending, or dissolving, a partnership for business purposes is governed by the partnership agreement and by statute in each state.** Though prospective business owners typically focus on starting and running the business, they should also carefully consider how the business might come to a close. Otherwise, they risk numerous unintended consequences if and when the time to end the business – willingly or unwillingly – arrives.



C CORPORATION

S CORPORATION



Overview

The corporate form is the most complex business structure. Its main advantages over other forms are: personal liability protection for those operating and investing in the corporation; means of raising money; and perpetual existence. Disadvantages include: limitations on control over how the business operates; tax consequences; and complexity.

The corporate form has five elements:

1. **Delegated management.** Board structure with operational control vested in officers
2. **Investor ownership.** Ownership is vested in shareholders.
3. **Legal identity.** A corporation is considered a "person" by law, holds many of the same rights as a natural person, and enjoys perpetual existence.
4. **Limited liability.** The owners of and investors in a corporation enjoy personal liability protection.
5. **Share transferability.** The ownership stake in a corporation is freely transferable in the form of shares.

There are two main corporate structures: C Corporation and S Corporation. Additionally, a corporation may be closely held, which means a limited number of people are shareholders, often family members. **Today, many smaller businesses, particularly closely held corporations, choose the S Corporation form because of its tax benefits.** If a corporation is larger, desires more flexibility in classes of shares it can offer, or will make a public offering (shares will be available for the general public to buy), it will likely choose the C Corporation structure. This section discusses C Corporations and S Corporations, with a discussion of Benefit Corporations at the end.

Formation

C CORPORATION

Unlike forming a sole proprietorship or partnership, forming a C Corporation requires formal action with the state. Importantly, you can incorporate in any state, even if you do business in a different state. Tax and governance choices affect the decision of where to incorporate. A corporation must pay a franchise tax in the state of incorporation and business taxes where it actually conducts its business. Deciding what law will apply to a corporation's structuring of its internal affairs should litigation arise also affects the decision of where to incorporate.

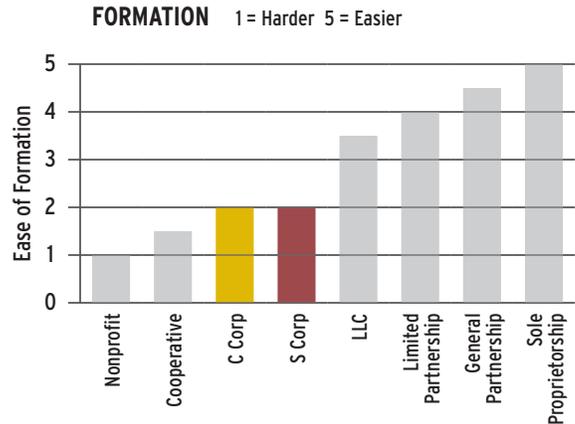
To form a C Corporation, you must:

- Choose an available business name that complies with the incorporating state's rules.
- Appoint a board of directors.
- Draft articles of incorporation and submit them to the secretary of state's office in the state of incorporation, along with a modest fee ranging from \$100 to \$800 (in addition to any necessary business licenses and permits).
- Draft bylaws, laying out the operating rules for your corporation.
- Hold the first board of directors' meeting.
- Issue stock certificates to the initial owners or shareholders.

While this process can be quite complex, sample forms are available online (see Resources), and costs can be kept down if the founders are willing to use common templates.

S CORPORATION

An S Corporation is formed just like a C Corporation. However, the shareholders must make an "S Corporation" election with the IRS on Form 8832 to be considered and taxed as an S Corporation. The election must generally be made on a prospective basis; however, the IRS will grant retroactive effect to an S Corporation election made within two and a half months of the beginning of the tax year (or March 15 for calendar year taxpayers). Failing to make this election means the corporation will default to a C Corporation.



Governance: Management and Operation

C CORPORATION & S CORPORATION

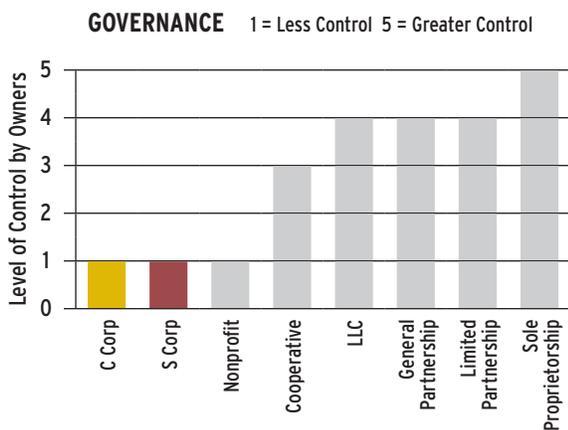
If the owners of the business want to retain significant control over the company and flexibility in management structure, they should think twice before forming a corporation. A corporation has a centralized management structure. You can think of this requirement (along with the tax structure) as the exchange for the state, and the federal government, allowing greater access to capital and personal liability protection.

The owners of a corporation are its shareholders.

For C Corporations, these shareholders may be divided into different "classes," depending on the type of stock they hold. With both corporate forms, stock may be divided into voting and nonvoting shares. Management of the corporation is entrusted to the executive officers. (A corporation can choose to have only one officer.) Thus, **ownership and management are, for the most part, divided.**

In between the owners and the managers is the board of directors. The board acts like a trustee of the corporation, monitoring the executives of the company. **The board of directors is charged with high-level decision-making, while the officers are responsible for day-to-day operations.** The directors must meet annually. Both officers and directors owe fiduciary duties to, and have other responsibilities for, the corporation. Officers and directors have no right to remuneration except as fixed by contract. The board must approve all financial distributions, such as dividend payments.

In sum, **the founders, and ultimately the owners, of a corporation often end up foregoing significant control over the operation of a corporation.** State law determines many formalities of the corporate form. A business can always change its structure to the corporate form. Therefore, think carefully about how much control you want over your organization before choosing this business structure.



Funding

C CORPORATION

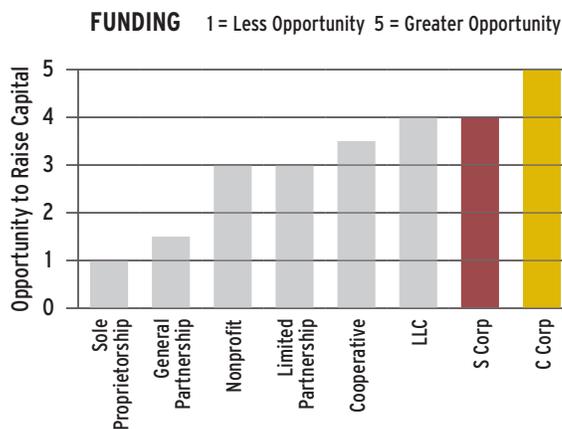
In exchange for more limited control over the business, founders of a corporation typically enjoy greater access to capital than other business forms. The ability to raise money is the biggest advantage to the corporate form. A corporation can raise money through equity by issuing stock or through debt from creditors.

Depending on the size of the corporation and who is receiving shares, the process of issuing stock is subject to many regulations. An attorney should be consulted prior to offering shares. C Corporations are allowed to create multiple classes of shares. This allows C Corporations to tailor agreements with investors by giving certain shareholders more rights with respect to voting or receiving dividends.

S CORPORATION

The S Corporation's ability to raise capital is similar to that of the C Corporation. However, S Corporations are limited to one class of stock and, currently, 100 shareholders. Those shareholders can be only U.S.

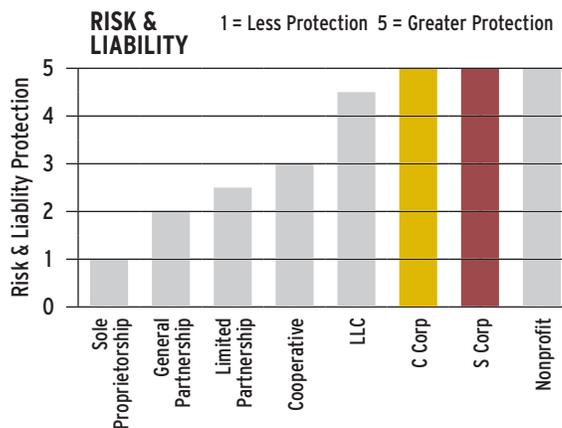
citizens and resident aliens, estates, and certain trusts.¹ **An S Corporation must also take care that it does not take certain actions or structure itself so as to jeopardize its S Corporation status.** For example, certain debt instruments have features of equity that could be considered a separate class of stock, which would cause the S Corporation to lose its status.



Risk and Liability

C CORPORATION & S CORPORATION

Another major benefit of the corporate form is that shareholders are not subject to liability from debts or other obligations of the corporation. They can lose only their initial equity investments. Note, however, that a bank or other large creditor may still require a smaller business to guarantee the loan personally. Also, in rare cases of fraud or inequity, a court may allow piercing of the "corporate veil" to allow creditors access to personal funds.



¹ An S Corporation can be a shareholder of another S Corporation in limited circumstances only.

Taxation

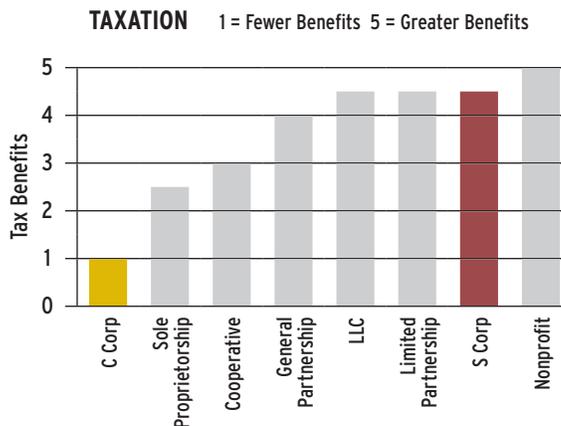
C CORPORATION

The primary disadvantage to the C Corporation is the tax consequences. A corporation is taxed at the state and federal levels. Most importantly, **a C Corporation is taxed at both the corporate level and the shareholder level – so-called “double taxation.”** This means that, first, the corporation is taxed on earnings at the corporate tax rate; and, second, employees must pay income taxes on their own earnings, and shareholders are taxed on earnings distributed as dividends. Additionally, when shareholders receive capital gains for selling stock, they are taxed on those gains. A C Corporation can limit corporate taxation through a variety of means. But the government regulates those practices. Having a trusted accountant and legal counsel are essential.

S CORPORATION

The reason many businesses choose the S corporate form over the C corporate form is that the S Corporation allows for pass-through taxation instead of double taxation. Only the wages of shareholders who are also employees are subject to employment tax. The remaining income is paid to the owner or owners as a distribution, taxed at ordinary income tax rates, if at all. This is a major advantage for some business owners. For example, if a business owner forms her business as an S Corporation, she will receive wages from the S Corporation that are subject to Social Security and Medicare tax. Any earnings the business generates over and above those wages are taxable to the owner at ordinary income tax rates but are not subject to these employment taxes. On the other hand, all profits generated by a partnership (or LLC, LP, or LLP taxed as partnerships) are subject to self-employment taxes, unless the partner is not actively engaged in the business of the partnership, in which case only ordinary income taxes may apply. **The more a business plans to generate income, the more beneficial it may be to form an S Corporation.** However, as noted above, an S Corporation does not allow for non-pro rata allocations of income/losses. Nor does it allow for tax-free distributions of appreciated property to its owners, as do partnerships, LLCs, LLPs, and LPs. Also, be aware that federal income tax law has unforgiving rules regarding the qualification for and maintenance of the S Corporation status.

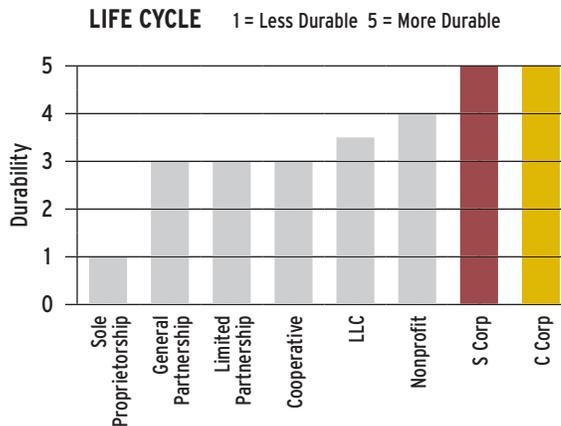
Most states also exempt S Corporations from corporate income tax. As with the C Corporation, you should consult with an accountant and a qualified tax attorney to understand the many tax advantages and potential pitfalls associated with the S Corporation.



Life Cycle

C CORPORATION & S CORPORATION

Corporations enjoy perpetual existence. This means that **dissolving a corporation is much more difficult than dissolving a sole proprietorship or a partnership.** Because it is a state-created entity, a corporation must follow prescribed procedures for coming to a close. This durability is typically viewed as an advantage – the actions of just a few owners or other stakeholders are insufficient to dissolve a corporation.



BENEFIT CORPORATION (B CORP)

The Benefit Corporation (“B Corp”) form allows a business to have a social, or public, benefit central to its purpose, instead of simply the maximization of profit. **The B Corp is currently one of the most attractive forms for businesses looking to prioritize financial, social, and environmental sustainability.** Legislation in over a dozen states has already begun to pave the way for expanding the B Corp form.

In a state with B Corp legislation, that state’s corporation laws apply to B Corps, except that there are explicit provisions unique to the B Corp form that allow, and require, B Corps to operate differently.

Three characteristics define the B Corp form:

1. **Purpose.** B Corps have a corporate purpose to create a material positive impact on society and the environment. A B Corp can also name a specific public benefit purpose, such as donating a quarter of its profits to food banks.
2. **Accountability.** Directors have a duty to consider non-financial stakeholders in addition to the financial interests of shareholders.
3. **Transparency.** B Corps have an obligation to report overall social and environmental performance using a comprehensive, credible, independent, and transparent third-party standard.ⁱ

Additionally, a shareholder or director has a right of action (can bring a lawsuit) if the B Corp fails to pursue or create a general or specific public benefit. A change in a B Corp’s stated purpose requires a two-thirds vote by its board of directors.

There are several advantages to becoming a B Corp if you want to make social and environmental benefit key to your company’s operations. **B Corp status means that directors and officers are not constrained in their decision-making to consider only the company’s financial bottom line.** In situations involving liquidity or sales of the company, B Corp status requires directors and officers to consider the public benefit, including non-financial interests. B Corp status also provides legal protection for directors and officers in these situations.

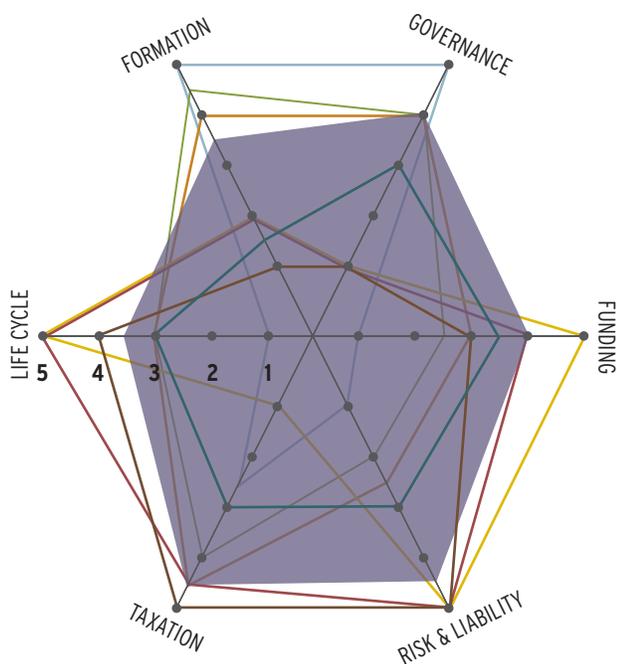
Having B Corp status shows the public that your company not only claims to have environmental and social purposes, but also that you have chosen to require your company to work toward those purposes in all aspects of its operation. Your company can then leverage this commitment with investors and consumers.

Both new and existing companies can become B Corps. Here are the recommended steps to form a B Corp:

1. On your own, or preferably in consultation with a lawyer, see if your state has a B Corp statute. If not, you can consider incorporating in a state that does. If you are an existing company, determine whether you need to amend your governing documents or formally adopt B Corp status to meet the state’s legal requirement for certification.
2. Talk with board members, legal counsel, and investors about the usefulness and implications of adopting the necessary legal changes in terms of raising money, selling the business, and altering directors’ liability.
3. Though not required, consider certifying as a B Corp through a third-party certification provider. If you are a start up, consider operating about half a year before getting certified. Otherwise, you may not be able to answer adequately some of the necessary questions required for certification.
4. Obtain board approval for the B Corp amendment.
5. Obtain shareholder approval for the board-approved B Corp amendment.
6. You can become a B Corp even if your business form is not a corporation. If your business is a corporation, file your amended articles of incorporation with the secretary of state within one year.ⁱⁱ

Because the B Corp is a relatively new concept, state law requirements will likely continue to evolve over the coming years.

LIMITED LIABILITY COMPANY



Overview

The LLC is a for-profit business form with similarities to the corporate form but with many advantages of the partnership form. In many ways, it combines the best aspects of both. The LLC has the benefits of limited liability, pass-through taxation (it is taxed the same as a partnership unless it has elected to be taxed as either a C or an S Corporation), a flexible governance structure, and less red tape than with a corporation. Instead of partners or officers, the LLC has members, or sometimes managers, that run the day-to-day operations. It is the form of choice for many businesses.

Formation

The LLC is a state-created entity, like the corporation. Each state has its own laws governing LLCs, though there are many similarities among states. Unlike a corporation, forming an LLC does not require appointing a board of directors, issuing stock certificates to shareholders, holding annual meetings, or many other formalities of the corporate form. **Though starting an LLC can be more complex than starting a partnership, it is simpler than forming a corporation.** Numerous resources are available to help make the process smooth and efficient (see Resources).

To form an LLC you must:

- Choose an available name for your business that complies with the state's LLC rules.
- File a certificate of formation – sometimes known as articles of organization or a certificate of organization – with the state (in addition to any necessary business licenses and permits), and pay the filing fee, which ranges from about \$100 to \$800.
- Draft an operating agreement, which structures the rights and responsibilities of the LLC members.

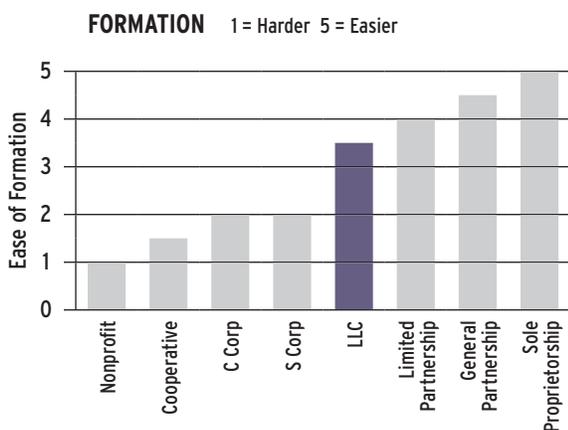
In several states, you must also publish a notice of intent to form an LLC.

The operating agreement is a hybrid of corporate bylaws and a partnership agreement. **The operating agreement is vital for protecting yourself from liability and for running a sound business.** It defines the financial and management structure of your business, allows you to override state default rules, and creates the foundation for running your company. The operating agreement should at least include:

- The members' percentage interests in the LLC, rights and responsibilities, and voting powers
- How profits and losses will be allocated
- How the LLC will be managed
- The rules for holding meetings and voting
- So-called "buyout," or "buy-sell," provisions, which determine what happens when a member no longer can or no longer wants to be part of the LLC

You can form an LLC in the state of your choosing. But you will likely still need to qualify your LLC to do business in your home state. This means filing additional paperwork and paying additional fees. To avoid the additional cost, smaller LLCs usually form the LLC in the same state in which they will operate.

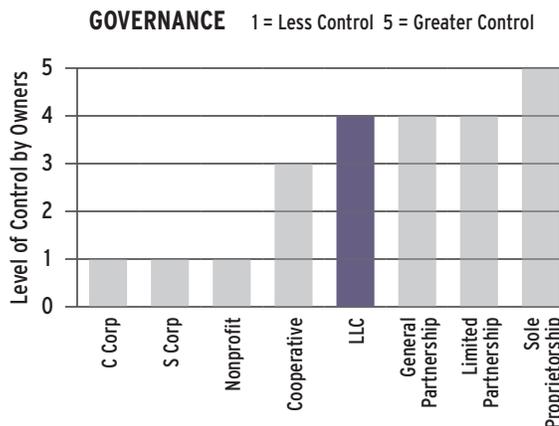
As with starting any business, think carefully before forming an LLC. This business form continues to evolve. You should **pay particular attention to how the LLC protects you from personal liability, and how that protection can fall away if you are not attentive.**



Governance: Management and Operation

Flexible management structure is a key advantage to the LLC. There are far fewer administrative burdens with LLCs than corporations. States have structured their laws so that LLCs have significant control over how they run their operations.

An LLC is owned by members, who run the day-to-day operations of the business. An LLC may choose to have one or more owners appointed as “managers.” Even non-owners could become managers. Managers vote on certain decisions and can act on behalf of the LLC. Be aware that this management structure might require you to address state and federal laws regulating the sale of securities. With either members or managers managing the LLC, some owners may play no role in running day-to-day operations, while others may provide no initial startup capital but are key employees of the company.

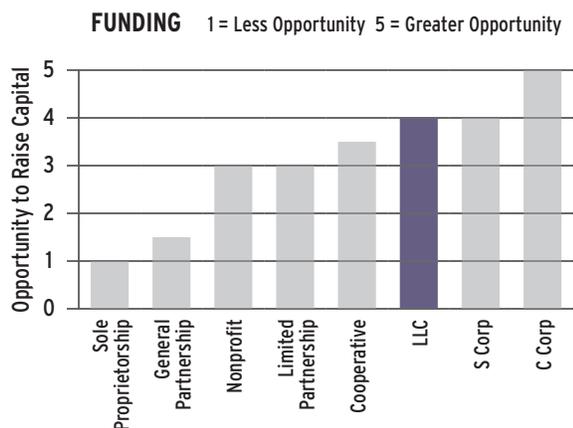


Funding

The LLC form has similar funding opportunities to the partnership form. **Members and possibly other investors supply the initial capital for an LLC. Like a partnership or corporation, an LLC can raise capital through debt and equity.** An LLC can bring in new members to supply more equity. Importantly, a member’s ownership shares in an LLC can be transferred.

LLCs can receive loans from conventional lenders, such as banks or other financial institutions, and from government-sponsored programs through traditional lenders or nonprofit intermediaries. Keep in mind that some institutional lenders may be wary of lending to a startup business. As with a smaller corporation, banks may require you to guarantee a loan personally.

Finally, **outside investors and nonprofits sometimes prefer to invest in C Corporations rather than LLCs (or S Corps).** If a foreign individual invests in an LLC operating in the United States, the investor will be deemed to be a partner doing business in the United States and will end up having a U.S. tax filing obligation in connection with the investment. However, a U.S. tax filing obligation would not result from a foreign investor buying shares in a C Corporation located in the United States. Also, LLC income allocated to a nonprofit that invests in the LLC will generally be subject to Unrelated Business Income Tax (“UBIT”). Dividends distributed from C Corporations to nonprofits are not taxed.



Risk and Liability

The liability protection offered by the LLC form is a tremendous advantage of this business structure over the sole proprietorship or general partnership forms.

As with a corporation, LLC members are shielded personally from debt and other obligations. Typically, members stand to lose, at most, their initial investment in the business. As noted above, however, bear in mind that banks and other institutions may require a personal guarantee on any loans made to small businesses. Personal assets may still be seized if the loan cannot be repaid.

You must take great care in creating your operating agreement. States offer broad flexibility in how you structure internal relations at your LLC. But state law dictates relations with third parties. Thus, even though you structure your business as an LLC, you can still be held personally liable if you:

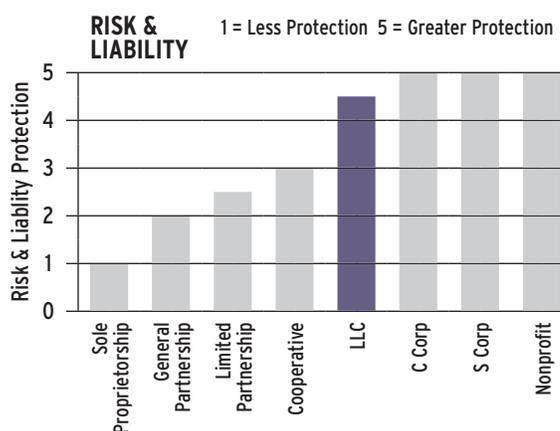
- Personally and directly injure someone
- Personally guarantee a bank loan or business debt on which the LLC defaults
- Fail to deposit taxes withheld from employee wages
- Intentionally commit fraud, an illegal activity, or another reckless act that harms the company or a third party
- Treat the LLC as an extension of your personal affairs instead of as a separate legal entityⁱⁱⁱ

It is crucial that you keep separate the LLC's business and your personal affairs. This may prove more difficult if you are a single member LLC (SMLLC), as you may be inclined to co-mingle funds. For an SMLCC, some states may be more willing to allow a creditor access to personal funds to satisfy debt.

Maintaining your LLC as a business separate from your personal affairs cannot be stressed enough. Make sure that you and any co-owners:

- **Act fairly and legally.** Do not conceal or misrepresent material facts or the state of your finances to vendors, creditors, or other outsiders.
- **Fund your LLC adequately.** Invest enough cash in the business so that your LLC can meet foreseeable expenses and liabilities.
- **Keep LLC and personal business separate.** Get a federal EIN, open up a business-only checking account, and keep your personal finances out of your LLC accounting books.
- **Create an operating agreement.** Having a formal written operating agreement lends credibility to your LLC's separate existence.^{iv}

The liability shield of the LLC is a great benefit to business owners. Respect (and appreciate!) the flexibility that states have granted to entrepreneurs with this business structure by carefully planning your business affairs.

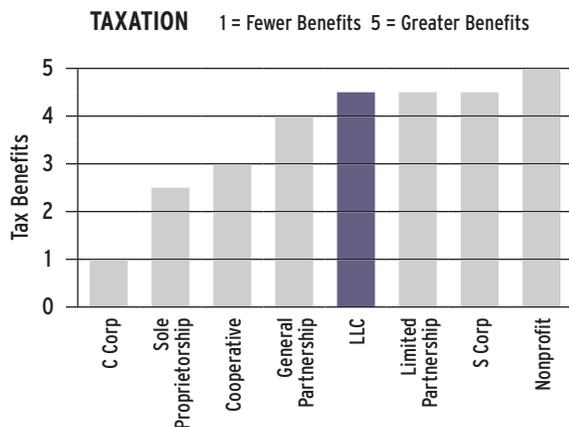


Taxation

Another advantage of the LLC is that it functions in many ways like a corporation but can be taxed like a partnership or sole proprietorship. In other words, income passes through to the owners – no double taxation. In this way, an LLC is taxed like an S Corporation. An LLC with two or more members is automatically taxed like a partnership unless it elects to be taxed like a corporation. An SMLLC is taxed like a sole proprietorship unless it elects to be taxed like a corporation. For a detailed discussion of the tax rules governing LLCs that have not elected C Corporation or S Corporation tax status, see the discussion of the taxation of partnerships above.

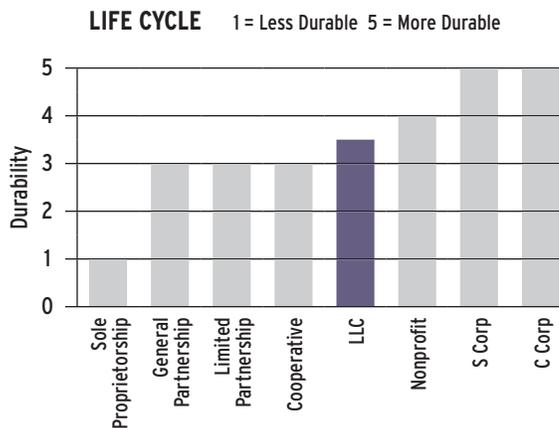
LLC member-owners who manage or help run the business pay self-employment tax on their distributive shares – their share of the profits. But if an owner is not active because, for example, he or she invests only capital in the LLC, that member may be exempt from this tax. The regulations are somewhat complicated, but expect to pay around twice as much in self-employment tax as regular employees, because regular employees' contributions are matched by their employers.

Nonetheless, LLC owners can deduct half of the total amount of their self-employment tax against their taxable income, which helps offset the larger self-employment tax. It is also possible to elect to be taxed as an S Corporation and avoid employment tax. You should consult with an attorney about the pros and cons of this alternative.



Life Cycle

In the operating agreement, an LLC can decide what is required to dissolve the company. **If an LLC fails to address dissolution in the operating agreement, when one member leaves, the LLC dissolves, like in a general partnership.** This dissolution process is very important because it puts others on notice that the LLC will wind down operations. It also ensures that the LLC will not continue to pay fees. The flexibility granted LLCs to determine the process of dissolving means that an LLC can effectively have a life span similar to that of a corporation.



LOW-PROFIT LIMITED LIABILITY COMPANY (L3C)

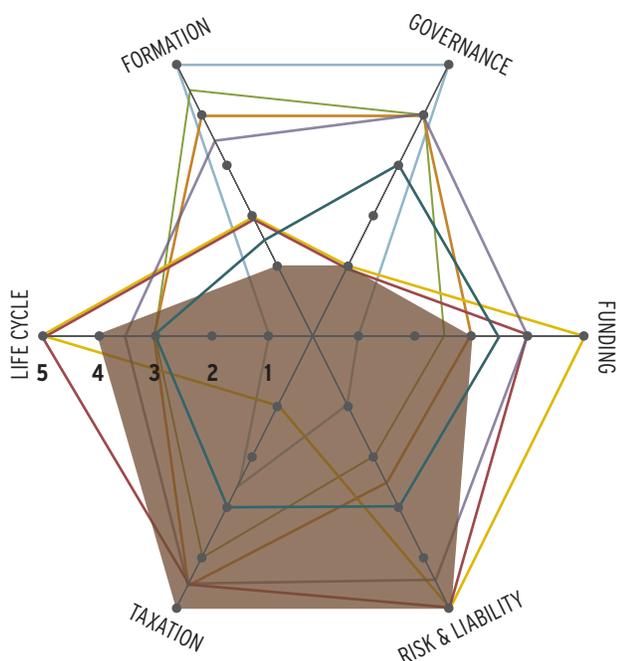
The L3C is a new legal form that combines aspects of a nonprofit and an LLC. **The L3C is essentially an LLC that has a primary public interest mission while retaining a greater ability to generate profits than a nonprofit organization.** Be aware that this form is not available in all states. However, you can start an L3C in any state that recognizes the L3C and, with only a few additional steps, operate it in your own state as a foreign entity.

The filing fees and process are the same as for an LLC, except that the organization must specify its mission and that it intends to be an L3C. **One of the major driving forces behind the creation of L3Cs was to help socially minded organizations raise funds.** L3Cs are meant to attract "Program Related Investments" (PRIs). A PRI is a loan, investment, or other financial backing from a charitable foundation, except it must be made primarily to further the foundation's social mission, with profit being only a secondary goal. As a result, PRIs are made on terms that are much more favorable to the recipient than ordinary market rates would be. In order to retain their tax status, private foundations must use about five percent of their assets to qualifying distributions, which include grants and PRIs. If the IRS deems that a PRI did not really go to a charitable purpose, it is not a qualifying distribution, and the foundation can lose its status.

Because L3Cs have a social mission written into their bylaws, the hope is that private foundations will more readily support them through PRIs. Thus far, foundations do not seem to be making many PRIs to L3Cs.

An L3C can also raise money in all the traditional ways, such as attracting investors or taking out loans. Note that unlike donations to a nonprofit, donations to an L3C are not tax deductible. Because they have a social mission, some investors may be scared away, but the tradeoff is that this mission may attract socially minded investors and make the L3C more appealing for new funding sources, such as crowdfunding.

NONPROFIT CORPORATION



Overview

A nonprofit corporation is driven by a charitable mission or social cause⁹ rather than by profit. To qualify for nonprofit status, the organization must be recognized as such by the state and the IRS. Unlike other organizational forms, nonprofits have no owners and cannot distribute their profits to investors. All profits must be related to the organization's charitable activities or its mission. Also, information about a nonprofit is available to the public. The main advantages to the nonprofit form are its tax-exempt status and personal liability protection for its directors, officers, and members. A nonprofit receives tax-exempt status under IRS Code Section 501(c)(3), which is why a nonprofit is often referred to as a 501(c)(3).

If you are more interested in a mission-driven organization than generating profit, consider the nonprofit corporate form. In addition to tax exemption and liability protection, nonprofits enjoy several other benefits, such as special postage rates and property tax exemptions. Though a nonprofit can fundraise through means not available to other business forms, it is unable to raise capital in ways open to corporations and other for-profit entities.

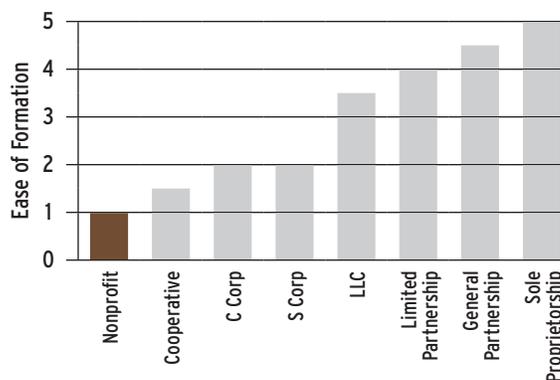
Formation

Forming a nonprofit corporation is similar to forming a for-profit corporation. You must:

- Choose a name
- File articles of incorporation with the state
- Complete state and federal applications for tax-exempt status
- Draft corporate bylaws that establish operating rules
- Elect directors
- Hold an organizational meeting of the board

The IRS form required to obtain tax-exempt status is particularly complex. **In addition to a relatively lengthy and resource-consuming startup process, nonprofits also have more onerous year-to-year requirements than other business forms.** As with other business forms, you should seriously consider obtaining the services of an accountant and an attorney to assist with the formation process.

FORMATION 1 = Harder 5 = Easier



Governance: Management and Operation

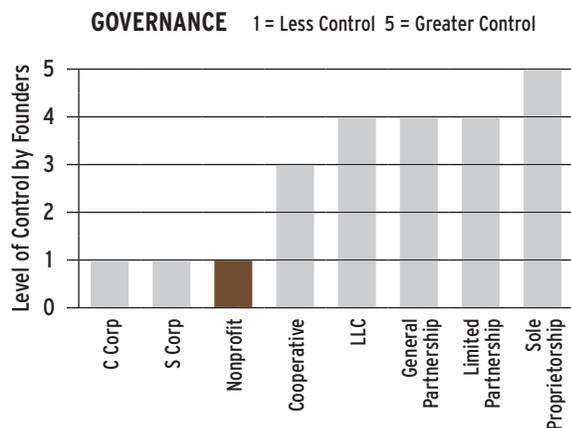
A nonprofit has no shareholders or other owners. **A founder of a nonprofit will therefore have less direct control over the organization than the founder of a business under some for-profit structures.**

A board of directors or trustees makes major decisions about the direction of the nonprofit. The board is in charge of selecting officers, who manage day-to-day

operations. Officers may serve on the board of directors. A nonprofit can choose to have members, in which case members may have the right to elect the directors. In a nonprofit without members, or one where members do not have such voting rights, the board chooses its own successors.

Nonprofits must observe many formalities of for-profit corporations, including keeping records, holding regular meetings, and maintaining a separate bank account for nonprofit funds. The IRS recommends determining governance policies that address:

- **Conflicts of interest.** Helps those associated with nonprofits understand how to deal with financial or other potential conflicts
- **Expense reimbursement.** Explains how to handle reimbursing officers, directors, trustees, and key employees
- **Whistleblower protection.** Protects employees who report financial or other problems with the organization
- **Document retention and destruction.** Establishes how long the organization must keep documents
- **Joint venture.** Determines how to handle relationships with for-profits
- **Gift acceptance.** Creates procedures for reviewing, accepting, and substantiating nonstandard contributions to the nonprofit
- **Chapter, branch, and affiliate policies.** If the nonprofit has chapters, this policy explains how to deal with those different parts of the organization.

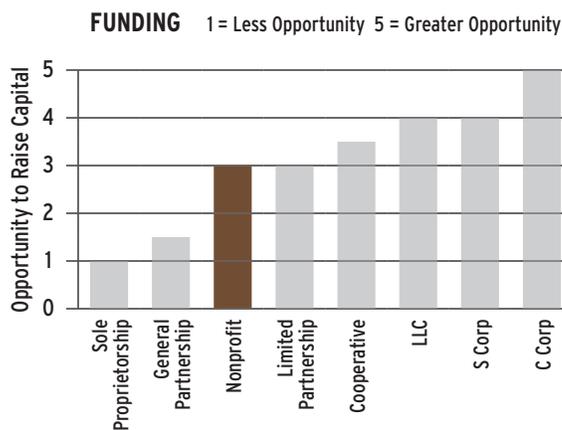


Funding

Contrary to popular misconception, a nonprofit is legally allowed to provide services for a fee and to make a profit from those services. But those profits cannot be distributed to owners or investors, political campaigns, or be used for lobbying activities. **Profits must be invested into efforts that further the organization's mission.** For example, a nonprofit food aggregation organization could charge for packaging, shipping, and marketing its products, and use any profits to create public outreach efforts or train new growers.

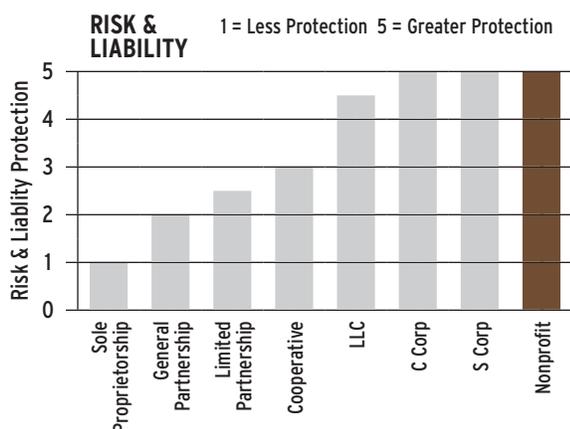
A major advantage of nonprofits is that many government programs and private foundations have grant opportunities available only to nonprofits.

The downside is that, because it is not allowed to distribute profits, it cannot attract investors like a for-profit corporation. Another advantage is that donations to a 501(c)(3) nonprofit corporation are tax deductible, giving this business structure a major leg up in fundraising. Note that achieving so-called 501(c)(3) status – and the subsequent ability to receive tax-deductible donations – requires a separate application to the IRS.



Risk and Liability

The directors, officers, trustees, and employees are shielded from personal liability. Nonetheless, as with other business forms that protect the business's personnel and directors from liability, that protection is not absolute. Incidents, such as fraud or gross negligence, can arise that would subject individuals to personal liability. **To protect the individuals associated with a nonprofit, and to protect the nonprofit itself, a nonprofit corporation should obtain several forms of liability insurance, such as general liability insurance, property insurance, directors and officers insurance, and professional liability insurance.**

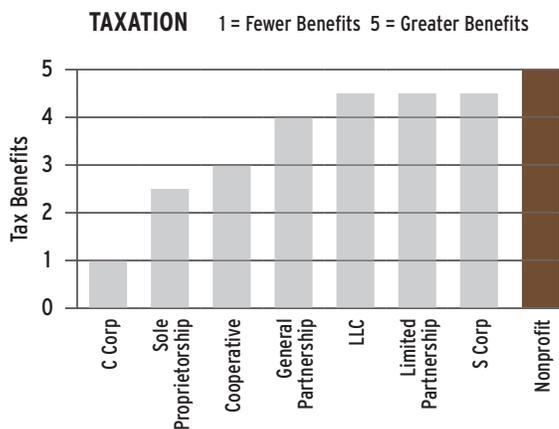


Taxation

The ability to qualify as tax-exempt is the greatest advantage to operating a nonprofit corporation.

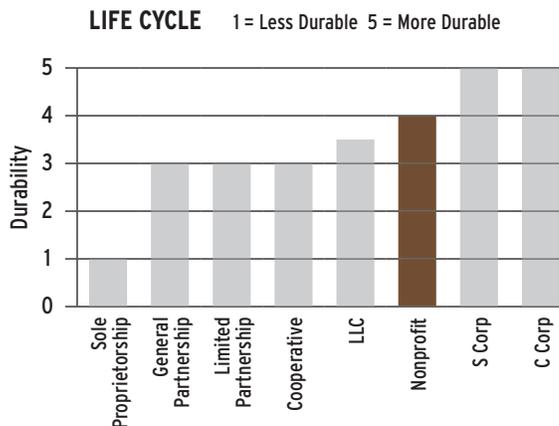
A nonprofit must qualify for tax-exempt status at the state and federal levels. In addition to being organized and operated exclusively for certain charitable purposes, no portion of the nonprofit's income or assets may inure to the benefit of an individual having a personal or private interest in the nonprofit. Moreover, nonprofits must maintain their nonprofit status through careful record keeping and annual filings. In other words, **a nonprofit must continually take affirmative steps to demonstrate that it is not legally obligated to pay taxes.** Again, consulting with an accountant or tax professional and an attorney is very helpful to ensure a nonprofit receives and maintains tax-exempt status.

Although nonprofits are generally exempt from income taxation, a nonprofit may still incur a tax on income it generates from a trade or business that is unrelated to its exempt purpose and is regularly carried on by the nonprofit. A nonprofit that has \$1,000 or more of gross income from an unrelated trade or business must file IRS Form 990-T.

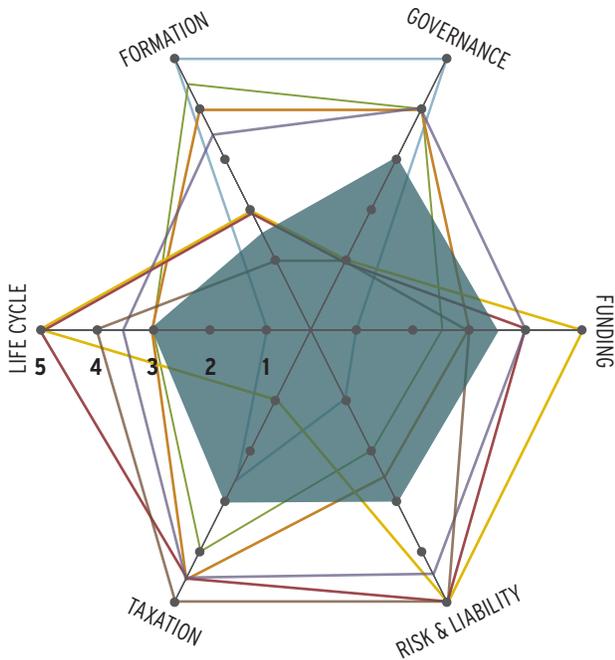


Life Cycle

A nonprofit corporation has perpetual existence, like its for-profit counterpart. However, it cannot be bought or sold. Before it can dissolve, it must pay off all debts and obligations and distribute its assets to another tax-exempt nonprofit corporation.



COOPERATIVE



Overview

A cooperative is an organization owned by and operated to benefit those using its services – its members.

In other words, those individuals who want the products or services of the prospective business come together to form a cooperative. Cooperatives are democratically run companies. They have several benefits, including pass-through taxation, expanded funding opportunities, reduced costs and expanded products and services, and a more democratic governance structure. Specific variations exist, such as an agricultural co-op, where the member-owners are farmers. Cooperatives can take on one of the previously discussed business structures.

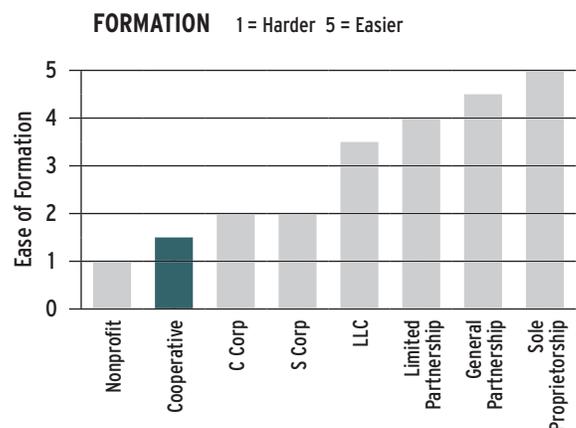
Formation

Starting a cooperative requires members to agree on a strategy to meet a common need. **Getting every member to agree on a business plan can be challenging.** A cooperative need not incorporate, but many do. Some become LLCs. A cooperative should strongly consider a business structure that provides personal liability protection.

Laws governing cooperatives vary by state. If a cooperative decides to incorporate, in general, it must:

- File articles of incorporation
- Create bylaws
- Create a membership application
- Hold a charter member meeting
- Elect directors
- Obtain any necessary licenses and permits
- Hire employees

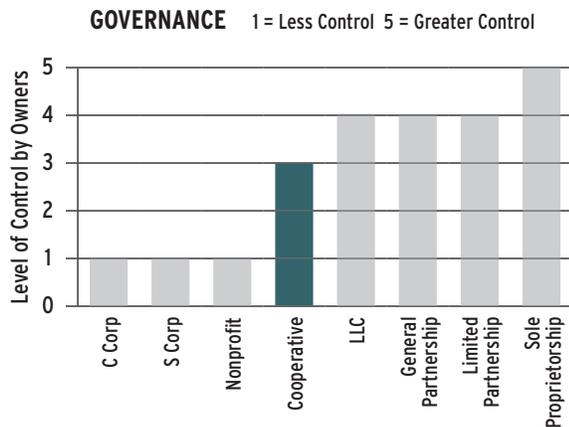
Ensure that in the articles of incorporation you clearly elect to be a cooperative. **Because the co-op is meant to be a democratically run organization, with many moving parts and potentially many members, it can be time consuming to form.**



Governance: Management and Operation

A cooperative is run democratically. Usually, an elected board of directors and officers run the day-to-day operations of the cooperative. Regular members (also known as user-owners) have voting power to control the direction of the cooperative. **Every member is entitled to one membership share, and every membership**

share gets one vote, regardless of the size of a member's monetary contribution. This structure is meant to ensure that no single member can dominate the decision-making process. Profits and earnings are distributed among the members. Members retain complete, though depending on the number of members somewhat diffuse, control over the cooperative.



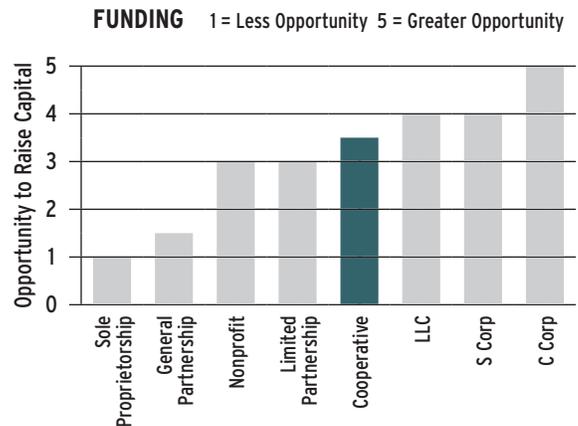
Funding

Initial capital for a cooperative comes from the members paying for their ownership shares. Paying for shares is a flexible concept. Employee-owned co-ops often allow new members to buy their way in by working a certain number of hours. Producer-owned co-ops may require that a producer sell a certain amount of product through the co-op before becoming a member. Keep in mind that this “buy-in” is the same for everyone, and no member gets more or less decision-making power.

Co-ops can raise debt or equity capital by taking out loans or selling non-voting shares to investors. Non-voting shares entitle investors to dividends. Because everyone must pay the same amount for a membership share, founders who want to invest more capital in the business can give themselves these non-voting shares to allow them to recoup their investment if the business is successful.

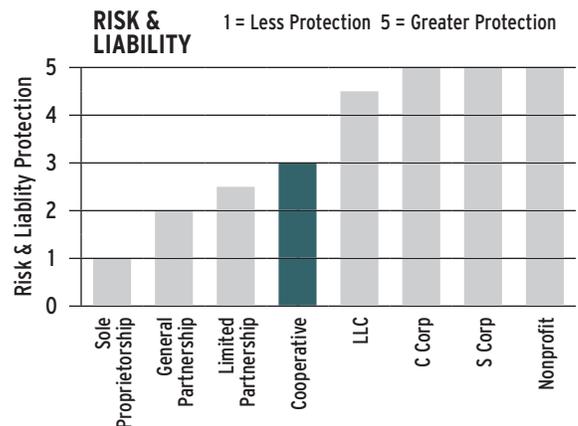
Profit distribution is controlled to some degree by state regulations, which may require that a certain percentage of profits be put into a reserve account for the co-op. Profits are then distributed to members based on a pre-determined factor – for example, how many hours

they worked, or how much product they sold. **Limitations on how a co-op distributes profits can make obtaining investments more difficult for a co-op than other business forms.** However, some investors may have a triple bottom line, i.e., social, economic, and environmental goals, and may seek out co-ops.



Risk and Liability

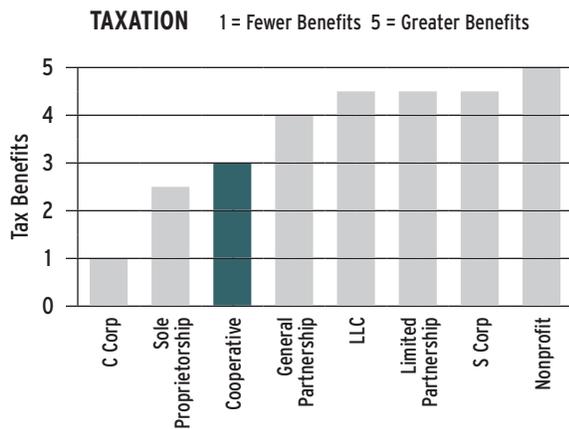
The amount of liability protection given to members of a cooperative depends on the type of business structure the cooperative chooses. As noted above, cooperatives should strongly consider a business form that gives members personal liability protection.



NOTE: For a cooperative, risk & liability varies depending on the business form chosen.

Taxation

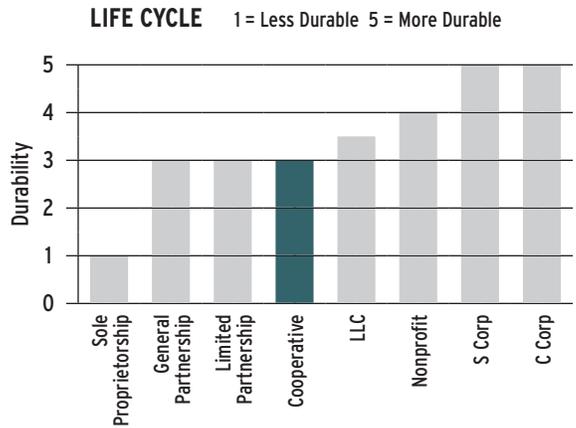
A co-op has a wide variety of tax options available depending on which business form it chooses, typically an LLC or a corporation. If a cooperative corporation meets the requirements of IRS Subchapter T, it could avoid double taxation on some of its profits if those profits derive from members' labor, are paid out to members as patronage refunds or dividends, and the cooperative complies with other requirements of Subchapter T. There is special IRS treatment for what are known as "agricultural cooperatives," but there are additional restrictions on their activities and the co-op must successfully apply to the IRS to receive this status.



NOTE: For a cooperative, tax benefits vary depending on the business form chosen.

Life Cycle

The life span of a cooperative depends on what business form it takes. Because it can become a corporation, it has the potential for perpetual life. In any case, the members of a cooperative must decide to dissolve the organization and follow its state's procedures for completing dissolution of the cooperative.



NOTE: For a cooperative, life cycle varies depending on the business form chosen.

PARENT/SUBSIDIARY RELATIONSHIP

Nonprofit Parent

There are several reasons why a parent company might choose to operate a business as a subsidiary. **For a for-profit subsidiary, a nonprofit parent may provide the existing infrastructure and expertise to shepherd the nascent business.** The nonprofit could form the for-profit subsidiary because it wants to engage in business activities unrelated to its exempt purpose. In a successful case, revenues from the other business may be so substantial as to threaten the nonprofit's tax-exempt status, or the parent organization may wish to own the organization as an asset. Alternatively, the parent may not want to take on the liability risks associated with the organization.

A nonprofit can also have a subsidiary that is itself a nonprofit. A main reason for this structure is that activities of the subsidiary may differ from the mission of the parent nonprofit.

How It Works

The subsidiary must be established and recognized as an independent company. The parent company still controls the subsidiary. This structure, if managed properly, does not threaten a nonprofit parent's tax-exempt status. The parent has the legal authority to hold the subsidiary accountable to financial objectives and policy requirements. The parent is the sole voting member of the subsidiary and holds the power to elect and remove the subsidiary's board, if one exists.

In order to maintain control and simultaneously let the subsidiary operate independently, a nonprofit parent should at least do the following:

- Be the sole voting member of the subsidiary
- If the subsidiary is an LLC or corporation, include provisions in its articles of incorporation for voting control and prohibit amending the articles without the approval of the sole voting member
- Draft bylaws that define the designation and authority of officers, terms of office, and removal

- If the subsidiary is a nonprofit or for-profit corporation, include in the bylaws the procedure for the parent to elect and remove directors

Officers of the subsidiary do not report to the parent company. But those in charge of the subsidiary still need to communicate with the parent organization. Ultimately, the subsidiary is accountable to the parent.

The parent need not worry about liability risk so long as it allows the subsidiary to operate independently.

You can think of the parent as a shareholder – the sole shareholder – of the subsidiary. It can hold the subsidiary accountable for performance expectations. But the subsidiary chooses how to meet those expectations.

A parent can, however, exercise too much control over the subsidiary by commingling funds, interchanging employees, having the same board, sharing space, using the same letterhead, or otherwise giving the appearance that the subsidiary is just a shell company for the parent. In these cases, a court could hold the parent liable under a veil-piercing theory. This outcome is unlikely unless it is absolutely clear that the parent and subsidiary were essentially indistinguishable.

For-Profit Parent

A for-profit should be wary of creating a nonprofit subsidiary. The opportunity for conflict of interest is great because a nonprofit must exist to benefit the public good. Unless the utmost care is taken to ensure the nonprofit has complete independence, it could lose its tax-exempt status. A more palatable scenario is for the for-profit organization to establish a wholly independent nonprofit entity or corporate foundation that simply receives its principal endowment from the for-profit entity.

CONVERTING TO A NONPROFIT OR FOR-PROFIT

For-Profit to Nonprofit

You may begin your operation as a for-profit entity and wish to convert to a nonprofit for a variety of reasons. For example, you may wish to access grant funds unavailable to for-profit businesses, or you may want the flexibility to focus on your mission instead of maximizing profit.

First, consider whether your current business activities qualify as charitable activities under section 501(c)(3) of the Internal Revenue Code (IRC). Consider consulting with an attorney or tax specialist.

Next, you need to study the applicable IRS regulations for charitable organizations. There are several types of tax-exempt entities other than those under section 501(c)(3). Again, you should **strongly consider consulting with legal counsel before converting your business to a nonprofit entity.**

Finally, check with your state agency to determine what filings the state requires you to submit.

Nonprofit to For-Profit

Conversely, you may wish to convert your nonprofit to a for-profit. This may help your organization get loans or business affiliations to operate more effectively. Or you may wish to take on business risks or maximize profits in a way that is incompatible with the nonprofit form. Regardless of your reason, take the time to consider this choice carefully. Conversion requires more than simply filing paperwork.

First, you should meet with a tax adviser to review your organization's tax returns and income potential. Importantly, **you must determine whether the benefit of getting loans and private funding is worth the amount of taxes you will end up owing.** Without these projections, you are walking blindly into a different business form.

Second, because your nonprofit will have a board of directors, you must get approval from the board. Present the case to the board, but listen to their arguments for and against. After the vote is recorded, you will need to notify employees, members, donors, and partners of your intent to convert to a for-profit entity.

Third, notify the IRS by writing a "statement of nonprofit conversion" that includes the reason for terminating your nonprofit status, a certified copy of a liquidation plan, the fair market value of your organization, and a list of all asset recipients if you are distributing assets.

Next, contact the attorney general in your organization's state of operation and request any forms you need in order to change to a for-profit at the state level.

Then, notify employees, members, donors, and affiliates about the official change.

Finally, file a final nonprofit tax return with the IRS within four months and 15 days of the termination of nonprofit status. As of this writing, this procedure is done with the e-Postcard Form 990-N if receipts are less than \$25,000, Form 990-EZ if receipts are less than \$1 million, and Form 990 for all other organizations.

CHOOSING AN ENTITY

Where to Start

Questions to consider:

- **What are your resources: money, time, physical infrastructure, and people?**
- **Whom should you consult?**

What are your resources: money, time, physical infrastructure, and people?

An organization can be about more than maximizing profit. It can aim for financial viability while simultaneously having positive economic, social, and environmental impacts in its community. **Spend sufficient time up front to ensure that your business embodies your mission and is structured in the best way to meet that mission.** You can always change your business structure as your company evolves. But taking the time to consider carefully this first, crucial step for your organization could save considerable money and energy down the road. Remember, the amount of time and money spent on deciding what business form will best meet your mission and goals is likely to pale in comparison to the amount of time and money it takes to run the operation successfully.

Here are questions to consider around each of the areas discussed in Part 1:



Formation process

- How much time and money can you devote to forming your business?
- How much effort and money will it take to maintain proper paperwork, tax records, and other reporting requirements?



Governance: management and control

- How much control do you want over major organizational decisions (selling or buying major assets, merging with other organizations, taking on major loans, etc.)?
- Who makes day-to-day-decisions?
- Who gets a say in drafting and changing the bylaws or other operational documents?



Funding

- What is the financial situation of the founders?
- How much access to capital do you have?
- What kind of investors do you want to attract?
- Do you want to be eligible for grants or government loans?



Risk and liability

- How much risk can you and your company afford to take?
- Do you want to be shielded personally from liability for actions of the business?



Taxation

- What type of funding do you intend to rely on?
- Do you want donations to your company to be tax deductible for the donors?
- Do you want all taxes to pass through to the company owners or shareholders rather than having the company itself taxed first on its income?



Life cycle

- Do you want your business to have a limited or indefinite life span?
- Do you want your business to have an existence independent from its owners?
- How easily do you want to be able to transfer assets of your business or sell the business as a whole?

The resources you have during the startup phase will strongly influence what business form you choose. These resources include money, physical infrastructure, time, and people. However, **resource capacity should not be the sole influence on your business form.** Even though limited time may cause you to begin operations as a sole proprietorship or partnership (by default if you do not actively choose another structure), you should nonetheless carve out time to conscientiously choose a business form.

Whom should you consult?

There is plenty of free information about the technical mechanics of forming a business. But consulting with an attorney to understand the legal and economic benefits of each legal structure given your particular circumstances may be beneficial. Attorneys will generally have free initial consultations, including an estimate of time and costs to start the organization. **Whether you are just starting your business or have been operating for a short time, you should strongly consider discussing your business form options with a lawyer and an accountant.**

Decision Point: Goals

Questions to consider:

- **What is your organization's mission or purpose?**
 - **What do you hope your organization contributes to the community? To its employees? To yourself or the other founders?**
-

What is your organization's mission or purpose?

Your mission can have a large impact on which business form you choose. **Different business forms are suited to different purposes.**

For-profit business models are generally designed for just that – making a profit. With a sole proprietorship, partnership, or an LLC, you have the flexibility to build a social mission into your organization. Nonetheless, these business forms are geared toward generating a profit for the company's stakeholders. What this means is that neither the law nor the state or federal tax structure explicitly incentivizes these business forms to do anything other than maximize profit.

This holds true to a greater extent for corporations, even though they may provide a social benefit through their products or services. A corporation's shareholders can successfully sue the directors if the corporation fails to maximize profits. Thus, if a corporation's officers or directors are choosing between profit and social good, profit will usually win out.

For these reasons, the benefit corporation, nonprofit, L3C, or a cooperative that takes on one of those business forms are attractive to socially minded individuals, who usually have a triple-bottom line in mind. Nonprofits are inherently about an underlying social mission, such as promoting local food or helping the environment. B Corps, L3Cs, and cooperatives combine profit generation and a social mission.

What do you hope your organization contributes to the community? To its employees? To yourself or the other founders?

Having a mission embodied in the organization can serve many benefits. First, it is a constant reminder to employees and managers to bake purpose into their daily functions. Second, having a clearly defined social mission can give organizations a leg up in branding themselves and marketing themselves to the public, grant-giving institutions, and some investors. Lastly, the organizational mission carries legal weight. Having a social mission written into your bylaws can protect management (and a board of directors if there is one) from investors who might claim the company failed to maximize profits. This is particularly true for the B Corp form. Also, in the event that the founders or other key members leave, having a mission written into the organization's DNA can prevent a new owner from using the business for a radically different purpose.

Decision Point: Control and Relationships

Questions to consider:

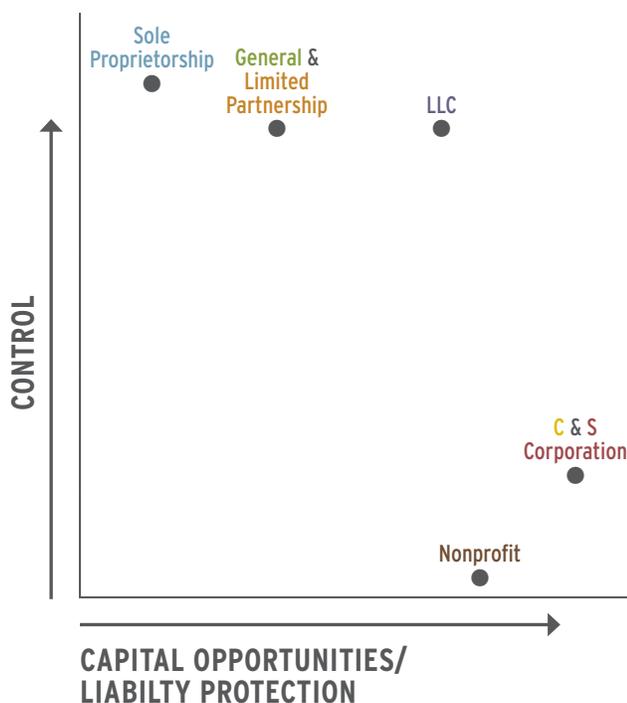
- **Who is involved in operating your organization?**
 - **Who are your customers and stakeholders, and what say must they have, if any, in running the organization?**
-

Who is involved in operating your organization?

One of the major considerations when choosing a business form is how it will affect control of the organization, the decision-making process, and relationships internally

and with your customers. **Forms with less owner control typically offer greater capital opportunities and liability protection** – what you give up in terms of personal control you gain in terms of capital investment opportunities and liability protection. Understanding what role funding, liability, taxation, and mission play in your prospective or current business should influence, or temper, how much control you would like to maintain over both the everyday and long-term decisions for your company.

TABLE 3: CONTROL AND CAPITAL OPPORTUNITIES/LIABILITY PROTECTION



As you can see from Table 3, a sole proprietorship gives you the most direct control over your company. But just being able to make day-to-day or even long-term decisions for your company does not necessarily equate to having the optimal amount of control over your business. On the one hand, if you lack adequate funding or expertise to make those decisions, the amount of direct control you have is worth little. On the other hand, if you relinquish control to a board of directors or shareholders, through either the corporate or nonprofit form, keep in mind that you may also lose some ability to affect the mission of your organization. As you evaluate other decision points on the way to choosing your business form, keep in mind how each one affects your level of control.

Who are your customers and stakeholders, and what say must they have, if any, in running the organization?

Well-intentioned people will hold very different ideas about how to balance competing interests. Some founders may desire to maintain as much control over this balance as possible. They may not want to consult a board of directors before making major business decisions, and may believe that being able to make quick decisions unilaterally is necessary to compete in the marketplace. In this case, an LLC or L3C will be ideal, with corporations being slightly less flexible but sometimes allowing more individual control than a nonprofit or cooperative. Keep in mind that some investors may still require that they have a say in major business decisions.

Some founders value having as much input as possible from stakeholders. This not only helps ensure that stakeholders have a say in how decisions are made so they may reap the benefits, but also allows the founders to benefit from the insight and expertise that others may bring to the table. One method of ensuring input is to create a board of directors that seats individuals from particular backgrounds. A board of directors exists for both corporations and nonprofits. As a sole proprietorship, partnership, or LLC, you can still have a board of advisers to assist you in the decision-making process but without binding you to their recommendations.

In the event that your business involves produce and the founders are producers themselves or have strong relationships with producers, the most effective way to ensure that voices are heard may be to start a producer cooperative. This gives each member one vote on decisions, regardless of how big or small the operation. While this can make decision-making a more arduous process, it has the benefit of allowing all voices to be heard.

The following is a list of some types of business decisions. Founders should seriously consider whom they would want to, and who should, have a say in these decisions when choosing a business form:

- How to structure employee compensation and benefits packages
- Whether to take on certain loans or investments or choose to pursue certain grants, particularly when any of those choices comes with strings attached or limitations on how the organization can spend the money

- How to spend leftover funds, which can include making major capital investments or paying dividends to shareholders
- Whether to change or increase services offered or the price of those services
- How and when to enter into long-term contracts to provide product to institutions, such as hospitals or schools, or other major institutional buyers
- How and when to expand operations to a new area or to purchase and sell different types of products
- Where the business will buy its product and from which producers
- If and when to enter into a relationship with another organization

Remember, **the more you disperse decision-making power and control to others, the more you must be willing to allow those people to have a say in the organization's purpose.** As an organization concerned about creating value for the community, be sure that you take time to ensure that the people you bring into the organization – whether as lenders, board members, or co-owners – are willing and able to fulfill the organization's mission.

Decision Point: Capital

Questions to consider:

- **How much startup capital will your organization need?**
 - **From what sources do you want to obtain short-term capital? Long-term capital? From what sources are you able to obtain this capital?**
-

How much startup capital will your organization need?

The biggest hurdle that most small enterprises face is accessing capital. Operators may face extremely high up-front costs, such as buying or leasing a warehouse, machinery, delivery vehicles, or other essential infrastructure. Ensuring businesses with whom your organization transacts receive a premium for their products, paying for storage, and delivering products requires significant capital. As a result, liquidity – having cash on hand – is important for an organization to meet operational needs.

From what sources do you want to obtain short-term capital? Long-term capital? From what sources are you able to obtain this capital?

If you have extensive cash on hand, you may be able to support initial growth without procuring outside investment. Most startup organizations will not be in this position. As a result, you need to consider how you would like to finance your operations. Choosing a business form that allows for greater outside investment may help get your organization off the ground but force you to relinquish more control.

There are several ways to obtain initial and ongoing capital. Some businesses rely on grants or low-interest loans – patient capital – to help begin their operations. Grants can come in all sizes and from a variety of sources, including local, state, or federal government, private foundations, or community development organizations.

Organizations can take on a variety of forms of debt, in addition to low-interest loans. Founders can obtain initial capital investments from outside investors, from the founders' savings, or from other businesses. Know that investment generally comes with two strings attached:

1. Investors will need to believe that there is a promise of future profits.
2. They may desire a say in the management of the organization to ensure that it is run in a way that benefits them monetarily.

Also, banks and other lending institutions may require that owners personally guarantee any initial loans, adding risk to the founders. The LLC and corporate forms will likely attract a broader array of investors or lending institutions.

The nonprofit form will have a major leg up in securing grants. Grants are made to support a particular goal. Being organized as a nonprofit devoted to furthering that goal gives some immediate assurance that the organization will use the grant properly. Some grants are restricted to nonprofits or public institutions. Because the grant process can be quite competitive, an organization may want to hire someone with experience crafting grant proposals if it hopes to use grants as a major source of funding.

Decision Point: Liability

Questions to consider:

- **What risks does your organization face?**
-

What risks does your organization face?

An organization must manage many risks. Each risk creates the potential for liability on behalf of the organization or owner, depending on the business structure. Your organization must be prepared for claims by third parties.

Depending on your business, to sell into certain markets, your organization may need to comply with specific practices and standards. Various laws may protect your organization from certain claims and give you the ability to ensure you get paid for your product. Any such laws are beyond the scope of this Guide. The bottom line is that you must carefully consider how well your business form protects you and your organization from liability.

Because an organization may face numerous opportunities for liability, you should strongly consider a business form that provides personal liability protection. The LLP, LLC, L3C, corporate, nonprofit, and cooperative forms all can provide varying degrees of personal liability protection. But, as explained above, know that some lenders may require you personally to guarantee loans.

If you start running operations as a sole proprietorship or partnership without limited liability protection, strongly consider shifting to a form that allows for liability protection once you have the time and resources to do so. Remember, forming an LLC can be a relatively simple process. Forming a corporation is also within reach if you are willing to expend a little more time and effort. Whether you choose a form with or without liability protection, you should at least be aware of what liability risks you and your business may encounter.

RESOURCES

Conservation Law Foundation Legal Services Food Hub:

<http://www.clf.org/our-work/healthy-communities/arm-and-food-initiative/legal-services-food-hub/>
CLF's Legal Services Food Hub matches eligible applicants with pro bono legal assistance from qualified attorneys. Eligible applicants include low-income farmers and food entrepreneurs, nonprofit organizations whose primary constituency or membership is farmers or food entrepreneurs, and community groups whose mission is to address social-justice issues related to the food system.

NOLO: <http://www.nolo.com/-NOLO>

NOLO provides an online site with free legal resources.

An LLC can obtain an EIN by:

1. Going online to irs.gov and clicking on the 'Apply for an EIN Online' link;
2. Calling 1-800-829-4933; or
3. Faxing or mailing Form SS-4, "Application for Employer Identification Number," to the IRS.

B Lab: <https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/legal-roadmap>

B Lab is a provider of third-party Benefit Corporation standards and certification. B Lab's website provides information about B Corps.

U.S. Small Business Administration:

<http://www.sba.gov/content/handling-legal-concerns>
SBA offers numerous resources for small businesses.

USDA: Regional Food Hub Resource Guide,

<http://dx.doi.org/10.9752/MS046.04-2012>

This is an excellent resource examining several successful food hubs across the country.

University of Vermont: Food Hub Management Certificate Program, <http://learn.uvm.edu/partners/cals/programs/uvm-food-hub/>

The University of Vermont offers the first food hub management certificate program in the country.

Wholesome Wave: <http://www.wholesomewave.org/our-initiatives/healthy-food-commerce-investments/resources>

ENDNOTES

ⁱ William H. Clark et al., *The Need and Rationale for the Benefit Corporation: Why It Is the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public 1* (2013), http://www.benefitcorp.net/storage/documents/Benefit_Corporation_White_Paper_1_18_2013.pdf.

ⁱⁱ See B Lab, *Protect Your Mission*, <https://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission> (last visited May 5, 2014).

ⁱⁱⁱ See *LLC Basics*, NOLO, <http://www.nolo.com/legal-encyclopedia/llc-basics-30163.html> (last visited February 27, 2014).

^{iv} *Id.*

^v For a definition of the types of purposes that qualify an organization for exempt status, see *Exempt Purposes – Internal Revenue Code Section 501(c)(3)*, IRS, [http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Purposes-Internal-Revenue-Code-Section-501\(c\)\(3\)](http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Purposes-Internal-Revenue-Code-Section-501(c)(3)) (last visited Mar. 3, 2014).