

## Entity Selection Overview

Choosing the right entity is an exciting and important step in the lifecycle of a business. The entity you choose helps outline roles and responsibilities among owners, guides you in conducting your business, and provides you with exit options, among other things. This document helps entrepreneurs think through the most important questions related to the entity selection process. Please note that the flowchart that follows is based on the laws of Pennsylvania. Entities are state-created legal organizations and thus the laws that govern them are specific to each jurisdiction. If you wish to create an entity outside of Pennsylvania, we urge you to consult an attorney familiar with the laws of that state.

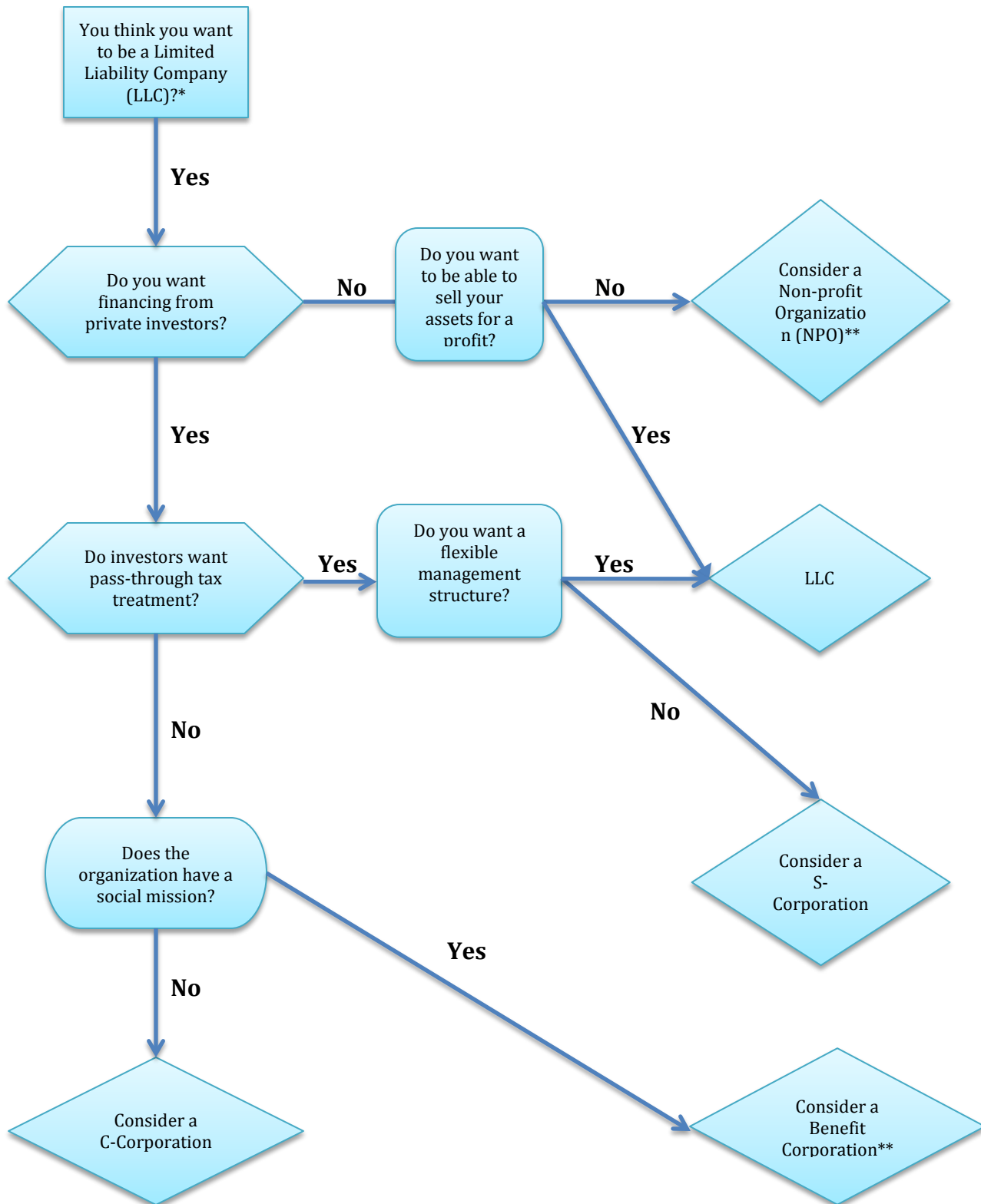
The flowchart starts with a limited liability company (LLC) as the default option. LLCs are the most common entity for entrepreneurs to choose because they provide greater flexibility than other entities and have fewer administrative formalities. The flowchart asks a series of yes-or-no questions that help the reader home in on what topics are most important to them. If the flowchart directs you to an entity other than an LLC, we urge you to further investigate that entity. In the appendix, we have provided information on three common alternatives to LLCs: Non-Profit Corporations, S-Corporations, and Benefit Corporations. The appendix is not a comprehensive guide and provides only a starting point for more investigation.

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### Disclaimer

These documents were created and vetted by students and supervising attorneys at the University of Pennsylvania Law School's Entrepreneurship Legal Clinic applying Pennsylvania law. They are intended to educate and inform the early stage start-up. As such, they are designed to be simple and accessible and may omit terms or language relevant to your specific circumstances. Please carefully read through the documents and any instructions and annotations included therein.

You acknowledge that your use of these documents does not create an attorney-client relationship between you and the Clinic or you and the individual members of the Clinic and does not constitute the provision of legal advice or other professional advice. You should seek advice from a licensed attorney before using or relying on these documents. Additionally, none of the documents created constitute tax advice. By using and relying on these documents, you assume all risk and liability that may result.



\*Start-up entrepreneurs commonly choose to form an LLC. The LLC gets pass-through taxation treatment during initial growth and can convert into a corporation tax-free.

\*\*If you are considering a non-profit organization or a benefit corporation, please see the Entity Selection Appendix below.

## **Non-Profit Corporation**

### **What is the Ownership Structure?**

Non-Profits are not owned by anyone.

The Non-Profit is controlled by a Board of Directors.

### **What are the Financial Benefits?**

Non-Profits are able to receive funding from multiple sources, including grants.

Individual donations to Non-Profits are tax deductible.  
Non-Profits can be exempt from many types of taxes.

### **What are Other Important Considerations?**

If a founder wishes to exit the Non-Profit, he simply leaves and the Board of Directors continues to run the organization.

Non-Profits offer limited liability similarly to other legal entities.

### **Where Can I Find More Information?**

Council of Non-Profits' [website](#) and the IRS [website](#).

## Limited Liability Company

### **What is the Ownership Structure?**

Owners are called members. Members can run the business or appoint a manager.

Members have membership interests.

### **What are the Financial Benefits?**

LLCs are usually treated as pass-through entities for tax purposes, meaning only the owners (not the entity itself) pay tax, generally resulting in less tax paid.

### **What are Other Important Considerations?**

LLCs are very flexible in terms of governance and management structure.

LLCs can normally convert tax-free into a corporation.

LLCs offer limited liability protection.

### **Where Can I Find More Information?**

Small Business Association's [website](#) and the IRS [website](#).

## **S-Corporation**

### **What is the Ownership Structure?**

S-Corps sell shares of stock that represent ownership in the corporation.

Owners elect directors to govern the business.

### **What are the Financial Benefits?**

S-Corps are able to raise capital through the sale of stock.

S-Corps are able to make a profit and pay out dividends to stockholders

### **What are Other Important Considerations?**

S-Corps can exist indefinitely and do not dissolve with the death or removal of an owner.

S-Corps cannot have more than 100 shareholders who generally must be actual people, not other entities.

S-Corps are pass-through entities for tax purposes.

### **Where Can I Find More Information?**

Small Business Association's [website](#) and the IRS [website](#).

## **Benefit Corporation**

### **What is the Ownership Structure?**

Generally the same as a corporation.

Some states require an additional benefit director on the board of directors.

### **What are the Financial Benefits?**

Generally the same as a corporation.

### **What are Other Important Considerations?**

Has all the advantages and disadvantages of a corporation.

Company can brand its social purpose and make decisions toward that end with greater security.

Some statutes require benefit corporations to create benefit reports.

### **Where Can I Find More Information?**

The Benefit Corporation's [website](#).

## **Frequently Asked Questions: Limited Liability Company (LLC)**

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### **What is a Member?**

A member is an owner of the LLC. Ownership interests are called membership interests. LLC operating agreements commonly state the rights and responsibilities of the members.

### **What is a Manager?**

LLC members can actively run the business. Alternatively, members can appoint a “manager” or “managers.” This situation arises when members want to take a more passive role in the LLC. Members can also be managers.

### **What is an LLC Operating Agreement?**

An LLC operating agreement lays out the rules governing that LLC. Operating agreements normally detail each member's rights and duties. States do not normally require members to create an operating agreement, but it is highly recommended that the members create one. Please see our LLC Operating Agreement Checklist below for some key questions to consider.

### **What Does “Limited Liability” in an LLC Mean?**

Limited liability in the LLC means that a member of the LLC is not personally responsible for the LLC's business obligations. This means that if someone sues the LLC, that person cannot go after the members' personal assets. In certain situations, e.g., when the company acts fraudulently, courts can hold members personally liable.

### **Can an LLC Have an Unlimited Lifespan?**

Yes, LLCs can have perpetual (or unlimited) duration. This means that even when an LLC owner dies, the LLC may remain active. Members must choose a perpetual duration. They can do this through the LLC operating agreement and the articles of organization.

### **Can I Convert an LLC Into a Corporation?**

Yes, LLCs can convert into corporations. One of the advantages of forming an LLC is that the LLC can generally convert into a corporation tax-free (this is not available for corporations seeking LLC status). Please consult an attorney when considering a conversion.

## Checklist: LLC Operating Agreement

Although an Operating Agreement is generally not required by law, it is the document that outlines the rules by which you will run your company. We highly recommend that you create one with the help of an attorney. Below are several key questions to consider before consulting an attorney that will streamline your process. For general information on LLC operating agreements, please see: <https://www.sba.gov/blogs/operating-agreements-basics-0> and <http://www.entrepreneur.com/formnet/form/805>

### Ownership Structure

- How much of the Company will each [member](#) own?
- Will there be more than one class of LLC interest?
- What and how much are the members contributing to the LLC?
- How will the voting rights be allocated among the members?

### Management

- How will major decisions be made?
- How will the LLC be managed? By all of its members or by [managers](#)?
- Do you want to have the equivalent of a [board of directors](#)? If so, what are its powers?
- How will profits and losses be allocated among members? (This can be different from ownership).
- What are the rules for holding meetings and taking votes?
- Does the LLC have a social mission? What is it and how is it measured?
- Will the LLC [indemnify](#) members for any liability issues?

### Restructuring

- How will you add new members?
- How can members sell their interests in the LLC?
- In the event of a [transfer](#) of a member's interest to a third party, are there any restrictions on those rights?
- What happens to the membership interests if a member dies?
- What are the events that lead to [dissolution](#), and what is the process for dissolution?

**\*Note:** This checklist does not constitute legal advice and should not be relied on as such. Entrepreneurs seeking to use any of the information in this checklist are urged to seek advice from a lawyer in regards to their specific circumstances.



## Appendix

What is the Entity?	Non-Profit Corporation	Limited Liability Company	S-Corporation	Benefit Corporation
<b>What is the ownership structure?</b>	<ul style="list-style-type: none"> <li>- Non-Profits are not owned by anyone.</li> <li>- The Non-Profit is controlled by a Board of Directors.</li> </ul>	<ul style="list-style-type: none"> <li>- Owners are called members. Members can run the business or appoint a manager.</li> <li>- Members have membership interests.</li> </ul>	<ul style="list-style-type: none"> <li>- S-Corps sell shares of stock that represent ownership in the corporation.</li> <li>- Owners elect directors to govern the business.</li> </ul>	<ul style="list-style-type: none"> <li>- Generally the same as a corporation.</li> <li>- Some states require an additional benefit director on the board of directors.</li> </ul>
<b>What are the financial benefits?</b>	<ul style="list-style-type: none"> <li>- Non-Profits are able to receive funding from multiple sources, including grants.</li> <li>- Individual donations to Non-Profits are tax deductible.</li> <li>- Non-Profits can be exempt from many types of taxes.</li> </ul>	<ul style="list-style-type: none"> <li>- LLCs are usually treated as pass-through entities for tax purposes, meaning only the owners (not the entity itself) pay tax, generally resulting in less tax paid.</li> </ul>	<ul style="list-style-type: none"> <li>- S-Corps are able to raise capital through the sale of stock.</li> <li>- S-Corps are able to make a profit and pay out dividends to stockholders.</li> </ul>	<ul style="list-style-type: none"> <li>- Generally the same as a corporation.</li> </ul>
<b>What are other important considerations?</b>	<ul style="list-style-type: none"> <li>- If a founder wishes to exit the Non-Profit, he simply leaves and the Board of Directors continues to run the organization.</li> <li>- Non-Profits offer limited liability similarly to other legal entities.</li> </ul>	<ul style="list-style-type: none"> <li>- LLCs are very flexible in terms of governance and management structure.</li> <li>- LLCs can normally convert tax-free into a corporation.</li> <li>- LLCs offer limited liability protection.</li> </ul>	<ul style="list-style-type: none"> <li>- S-Corps can exist indefinitely and do not dissolve with the death or removal of an owner.</li> <li>- S-Corps cannot have more than 100 shareholders who generally must be actual people, not other entities.</li> <li>- S-Corps are pass-through entities for tax purposes.</li> </ul>	<ul style="list-style-type: none"> <li>- Has all the advantages and disadvantages of a corporation.</li> <li>- Company can brand its social purpose and make decisions toward that end with greater security.</li> <li>- Some statutes require benefit corporations to create benefit reports.</li> </ul>
<b>Where can I find more information?</b>	<p>Council of Non-Profits' <a href="#">website</a> and the IRS <a href="#">website</a>.</p>	<p>Small Business Association's <a href="#">website</a> and the IRS <a href="#">website</a>.</p>	<p>Small Business Association's <a href="#">website</a> and the IRS <a href="#">website</a>.</p>	<p>The Benefit Corporation's <a href="#">website</a>.</p>