Financing of Non-Corporate Entities

Group A: ***See Financing & Controlling Corporate Entities***
Group B: Jake, Sierra, Ryan
Group C: ***See Financing & Controlling Corporate Entities***
Group D: Alexzandra, Alan, Michael, Daniel

Group B: Financing & control of Limited Liability Companies - Manager Managed Perspective

Group D: Financing & control of Limited Liability Companies - Member Managed Perspective

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Objectives of the Clients regarding financing & control

Two promoters, Alice and Andy, have designed a new and powerful algorithm for searching internet web sites. They will be forming a general partnership, or a limited partnership or an LLC ("TouchSearch Partners" or "TouchSearch L.P." or "TouchSearch LLC"). They need **$10 million** in seed money to start up and sustain the business for the two years. Alice and Andy are anticipating that, after two years, they will sell the business, or seek a growth-oriented second round of financing.

Alice and Andy each contributing $250,000 in cash + $750,000 in I.P. and pre-formation services. ($1 million each). Alice and Andy will be employed by the entity and receive appropriate compensation packages for the work they will perform. Alice and Andy need to retain substantial control over the management of the entity. There will be 8 "outside investors," all of whom are wealthy, sophisticated and willing to contribute $1 million in cash each.

The 10 equity holders (Alice, Andy & 8 outside investors) will each own 1/10th one-tenth of the equity of the entity but the outside investors will receive priority rights to payment with regard to both distributions of profits and proceeds from the sales of assets. The eight outside investors will have voting rights with respect to fundamental decisions such as mergers, acquisitions or other major entity decisions but Andy and Alice will have the rights to manage the general affairs of the entity.

Discuss:

The Non-tax pros and cons: What are the benefits and detriments of using this type of format for a financing plan. Consider factors such as:

- Control objectives. How are voting rights allocated under the statutory default rules and how can they be altered?
- How are profits and losses allocated? What is the statutory default rule and

what are some alternatives to the statutory default rule.

  - What problems may arise if there are unequal cash contributions by the by the equity holders?
  - Does it make sense to have some equity holders contribute a portion of their investment in the form of debt rather than equity?

- What types of consideration for equity interests may be exchanged for an equity interest?
- Ease of *borrowing* money from a commercial lender
- Assuring moneyed investors a priority of distribution with regard to profits?
- Assuring large cash investors a priority of distribution in the event of sale or liquidation of the entity
- The problem of raising future *investment* capital

<u>The tax pros and cons</u>: What are the benefits and detriments of using this type of financing a tax viewpoint. Consider factors such as:

- The general tax advantages or disadvantages of using this type of entity
- The problem of “substantial economic effect”
- The tax consequences to individual investors contributing property or services in exchange for an equity interest.