gust LAUNCH

Gust's Guide to
Startup Incorporation

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1. Introduction

Welcome to *Gust's Guide to Startup Incorporation*! If you'd like the easy way through this process, close this pdf and direct your browser to gust.com/launch, where you can apply to join our Company-as-a-Service™ platform, Gust Launch, and take care of your incorporation the right way in just a few minutes. For a thorough account of the possibilities and potential concerns your startup will face as it chooses a path through the incorporation process, read on.

Incorporation is a term that refers to **starting a company**. When it's time to engage in business activities, it can be tough to assess which sort of company provides the most benefits to a potential business, and to find out specifically what these costs are ahead of time.

This book was written specifically for people who plan to build high-growth startups[1], such as the Airbnbs, Ubers, and Facebooks of the world. It is the product of research by Gust's legal and product experts, and sets out to answer the following questions, which anyone starting their first (or second, or tenth) business will have about the process:

1. What is a company and why should I create one?
2. What type of incorporation is right for my company?
3. How do I go about incorporating my company?

To answer these and other questions, we'll present everything you need to know and explain how each piece of information relates to your situation: a founder looking to create a company that is optimized for stability, growth, and investment.

1 Not sure if you're starting a high-growth startup? It's likely that your company is a high-growth startup if you are expecting to do any or all of these things: hire employees, issue equity, seek professional investment, grow rapidly, and exit via either an initial public offering (IPO) or acquisition by a larger company.

2. What Is a Company? Why Do You Need One?

In the simplest terms, a company is a legal designation that you can create by telling your various governments (state, local, and federal) about your intention to do business under that name. Within the category of "companies," there are several kinds of entity, which can be understood as a handful of categories (with more specific types inside each category). Some of the most common categories are:

1. Sole Proprietorship	**2. Partnership** • General Partnership • Limited Liability Partnership
3. Limited Liability Company (LLC)	**4. Corporation** • C-Corporation • B-Corporation • S-Corporation

The first two are simply ways for a person or a group of people to announce that they will be doing business under a name other than their legal name. For example, a slushy salesman named John might do business as the sole proprietor of John's Slushies. If he had a partner, Maureen, they might do business as The John & Maureen Slushy Partnership. In either case, John (and/or Maureen) have no protection as actors in situations involving the company: they are the company and are personally responsible for any debts or obligations they enter into as the company. [2]

Because companies often work on scales much larger than individual people do, the law permits the creation of companies which exist separately from the people who own and/or run the company from a legal standpoint. The rest of the types of companies above have this trait, which enables the law to consider them separately from their owners, employees, or operators in some or all of the following ways. Each of these effects can separately be a compelling reason to create a company.

2 This paragraph specifically concerns General Partnerships. In a Limited Liability Partnership, all limited partners will be protected by the same limited liability functions as partners in an LLC, while any general partners will be treated as members of a General Partnership, i.e. they will not receive protections.

REASON #1

Limited liability

LLPs, LLCs, and corporations are meaningfully distinct entities from the people who own them, but can mostly do the same things (like enter into contracts or buy and sell products). But while a person who is doing business activities as herself is personally liable for them (and their effects), members of a corporation are not personally liable for the activities and agreements made by the corporation. This is called “**limited liability**” and it is one of the most compelling reasons to form a company.

So, if a court judges against your startup for some reason in a suit, or if you find yourself unable to fulfill contracts—whether they’re with employees, contractors, suppliers, or customers—the courts or the other party in the contract won’t come after you and your personal assets. Instead, the corporation is responsible for bearing any penalty.

REASON #2:

Collecting and owning assets & IP

Like liability, many of the benefits of incorporation are tied to the company's status as an independent entity. This entity can own assets like capital, equipment, and intellectual property (IP). All of these assets increase your company's value, especially from the perspective of future investors and existing shareholders.

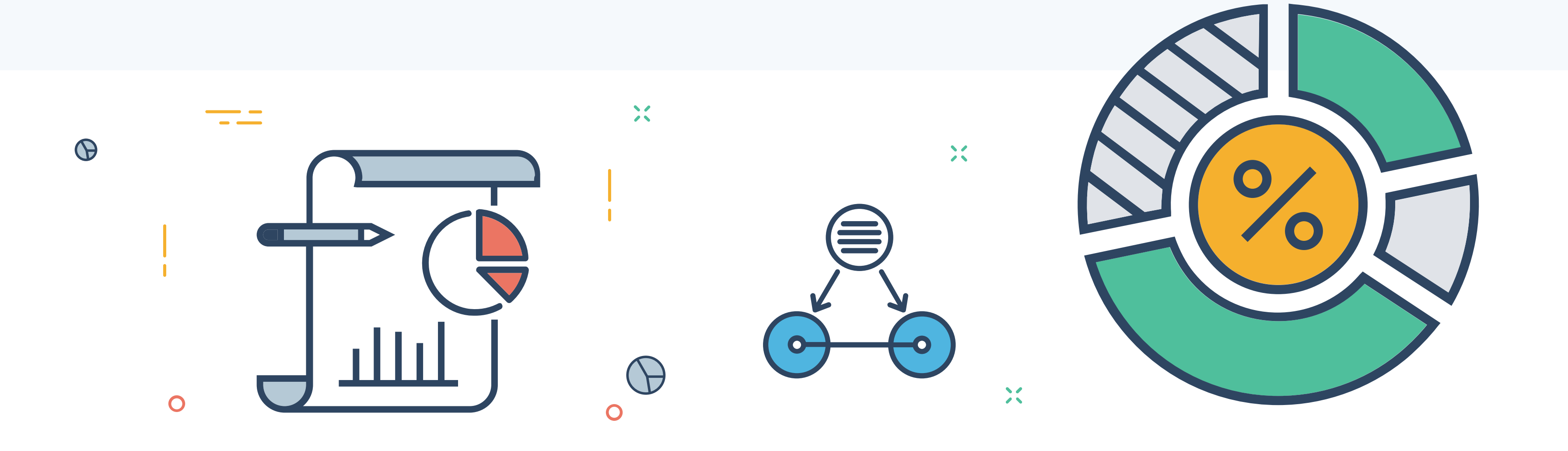
The last kind, intellectual property, is especially crucial for high-growth startups, which tend to focus on developing disruptive new technologies or techniques (rather than reusing established business models, as many other small businesses do).

Just like with debt, you want ownership of these intellectual property assets to be the property of the startup, not the individual founders. In this arrangement, each founder's contributions will remain with the company even if they leave, which has two big benefits: first, it means that nobody can hold the company's future hostage purely on the basis of their past contributions, and second, it provides a sensible justification for each contributor's equity stake. There's also a financial benefit, which is that the value created by the intellectual property can be considered part of the value of the company, which is the main mechanism investors use to decide how much money to put into a startup.

If you do not protect your IP early then you'll introduce downstream risks on future financings and/or in the market through competition. Keeping that IP within the walls of an incorporated entity reduces risks if done properly, and they can benefit from corporate laws that have already been built around scenarios like this.

REASON #3

Dividing and distributing ownership



The assets and revenue created and owned by a company as well as any investment it takes in all contribute to the company's overall value. This value manifests itself in a few forms—corporations may distribute some profits to shareholders as dividends; the assets may help justify a valuation in the minds of investors; capital contributed by investors might be added on top of a valuation as a representation of the company's overall worth.

In all of these ways, the relevant parties understand the value as being divided up according to **shares**. A business entity, unlike a person doing business without forming a new legal entity, can have multiple owners, whose ownership (also known as **equity**) is divided into an arbitrary number of pieces. This concept is legally complicated, because equity can be distributed in many forms depending on the company's type, structure, and bylaws, but in all cases the point of the division is to explain who owns the company and how much of the company each shareholder owns.

Investors usually put money into companies in exchange for some amount of equity. Employees often receive equity as an incentive to work hard on behalf of the company. Company founders retain large portions of equity in exchange for their hard (and usually free) work before the company had any real value. The existence of a legal entity that can have many owners makes it possible to articulate all these relationships and make sense of how they deliver value to each party.

When it’s time to form a company

Incorporation can be both expensive and confusing, which is why many founders delay the process. So when exactly should you incorporate your startup? The short answer is: as early as possible.

Specifically, you’ll want to be incorporated as soon as (or before) you have any of the following:

A partner	**A customer**	**Any intellectual property** (including trademarks or computer code)
An employee	**A grant**	**Any potential liability**
An investor	**A need for a bank account**	**Any assets**

For reasons that vary case-by-case, every event on this list separately amounts to a need for an entity separate from yourself that can be held liable in case of debt or penalty, can own an asset, or can distribute shares of itself to investors.

3. LLCs and Common Corporations

As we mentioned in the previous chapter, companies come in many types. For high-growth startups in the United States, there is really only one ideal choice (a Delaware C-Corporation[3]), but there are technically many options.

The four most popular of these are an LLC or three slightly different types of corporation: C-Corporation, B-Corporation, and S-Corporation.

3 It's important to note that most types of companies are registered with state governments, not the federal government, so there may be slight differences in the ways these entities behave on a state-by-state basis. We'll discuss this a little in chapter 4, under the heading "Why Delaware?"

(LLCS)

Limited liability companies

LLCs are extremely simple arrangements in which every owner is a partner. An LLC basically provides the limited liability protection for which people form companies, but does not do much else. Each company which chooses to incorporate as an LLC drafts an “operating agreement” among the owners, which contains all the rules by which the company operates. This operating agreement is similar in function to the bylaws of a corporation, but due to the bespoke nature of each LLC’s structure, there are no standard components for this document (although there are common features).

LLCs are also not independently subject to corporate tax: an LLC is effectively invisible (for tax purposes), and “passes through” any net income (without being taxed at the LLC level) to its owners, who then treat it as taxable personal income. Whether or not any money actually passes from the LLC to the individual, the individual owner must pay income tax on their share of the profits (or losses) generated by the LLC. Every year at tax time, every LLC must send every one of its members (and the IRS) a Form K-1, showing that member’s personal share of the company’s profit or loss.

The features which tend to make LLCs popular—namely, their pass-through taxation structure and their liability limitation without the need for a full corporate structure—make them well-suited for people who simply want a business entity through which to do business. For high-growth startups, they are generally not well-suited, for reasons we will address in subsequent sections.

C-Corporations

C-Corporations are the most popular type of American corporation. They are different from LLCs in a few ways. The first is that, rather than an operating agreement, corporations abide by bylaws written into their articles of incorporation, for which there are many regularized and standard structures. Due in large part to their popularity, C-Corporations enjoy the benefit of having both state and national courts which are familiar with their features and behaviors, so the operating a corporation as it scales is somewhat easier and less lawyer-intensive than other types of companies.

The second key difference between a C-Corporation and an LLC is the way in which it is taxed. C-Corporations are subject to a separate set of taxes than their owners or operators are. A C-Corporation pays annual corporate taxes based on its taxable net income, and then if it distributes any money to its shareholders (known as “distributions”), the shareholders themselves are required to pay personal income taxes on the amount they receive.

The third defining feature of a C-Corporation is that it comes with an out-of-the-box mechanism for distributing equity. This is called stock. At incorporation, corporations authorize a certain number of shares of themselves (which can be increased at any time) and can subsequently issue these shares to their owners (such as founders and investors). Because this instrument is well-understood, this is easy to accomplish without involving lawyers.

C-Corporations are by far the best-suited corporate entity for high-growth startups. We’ll specifically address the reasons why this is so in subsequent chapters.

(B CORPS)

Benefit Corporations and Certified B-Corporations

Most corporations are generally assumed to have the primary goal of maximizing their value for shareholders. In the past few decades, many companies (especially startups) have shown interest in expanding their range of aims to include various kinds of altruistic and socially positive goals—traditionally solely the concern of nonprofit organizations—to which the law refers generally as “public benefit.”

Corporations who seek to include some public benefit in their purpose have a legal entity option called a Benefit Corporation (sometimes confused with a B-Corporation). This entity is not available to companies in all states, and generally differs primarily in ways that are related to its public benefit goals, such as accountability to shareholders and transparency—for most other structural and tax-related concerns, it is similar or identical to a C-Corporation.

These companies can also (optionally) choose to become Certified B Corporations, which is a third-party certification offered by the group responsible for the creation of the Benefit Corporation legal entity and is not a type of corporate legal structure in its own right.

S-Corporations

Some C-Corporations can optionally file Form 2553 with the IRS, which changes the C-Corporation into a “Small Business Corporation,” popularly known as an S-Corporation. S-Corporations are essentially just an election for pass-through taxation status, and are perhaps best considered a subcategory of C-Corporation designed to compromise between the corporate rigidity and standardization of a C-Corporation and the tax-invisible nature of an LLC.

The rules that determine which businesses can elect to be treated as S-Corporations are somewhat restrictive and a little confusing, but in practice end up working for most high-growth startups. To be eligible, a company can’t operate within certain industries, and must have fewer than 100 shareholders (although a married couple or an estate can count as a single shareholder), all of whom are individuals (or “certain trusts” and estates) rather than corporations or partnerships, and all of whom are residents of the United States. In addition, an S-Corporation can only have one class of stock.

Business structure comparison

	C-CORP	B-CORP	LLC	SOLE PROP.	GEN. PRTNRSHP	LTD. PRTNRSHP
Offers liability protection	✓	✓	✓			
Can own assets & IP	✓	✓	✓			
Can grant stock	✓	✓				
Owners can split profits/losses w/ business	✓	✓				
Owners can report profits/losses on personal tax returns	✓	✓	✓	✓	✓	
Created by state-level registration	✓	✓	✓			
Ease of raising funds	Easy	Moderate	Moderate	Difficult	Difficult	Moderate
Ongoing record keeping reqs.	Extensive	Extensive	Moderate	Few	Few	Few
May have an unlimited number of owners	✓	✓	✓		✓	

4. Which Type of Company Should a High-Growth Startup Choose?

Now that we've looked at the myriad types of companies available to an entrepreneur seeking to become the founder of a high-growth startup, we can compare them to each other on the basis of their benefits and drawbacks. There are two main categories of stakeholder a startup founder should consider: themselves (and their cofounders) and the investment community.

There's a right answer—spoilers: it's a Delaware C-Corporation—but to understand exactly why, we'll walk through all the potential ramifications of each choice.

The startup founder's perspective

As Daniel DeWolf at Mintz Levin puts it, "Incorporating as a C-Corporation in Delaware is the gold standard for high growth startups. It provides limited liability, ease of use, ease of setup, the ability to issue stock options, and tax benefits upon sale for many qualified small businesses."

The two key differences between an LLC and a C-Corporation are the ability to divide ownership and the way in which their income is taxed.

While it's possible to develop workarounds for an LLC to divide its ownership structure, notably profits interest (which signals an intent to divide profits at a later date, counting from when the interest was granted) and capital interest (which represent portions of the value of the company if it were to be liquidated), these don't exactly translate to stock or ownership in the obvious, comparatively intuitive ways that shares of a C-Corp do.

On top of these differences, LLCs entirely lack a way to grant options, which are a common equity incentive format that startups give to employees and advisors that more or less represent the ability to purchase shares of the company at a discount when it's advantageous to do so. Since almost any successful high-growth startup will seek professional investment, these structures will need to be converted into analogous C-Corp ownership units (i.e. shares). In short, that's a lot of expensive lawyer time.

Despite the comparative difficulty an LLC introduces as a result of its inability to directly issue stock, many startup founders are still hesitant to choose a C-Corp structure. The number-one reason is because they've heard about the "tax advantages" of LLCs: many first-time founders hear that a C-Corporation's profits are "taxed twice," compared to an LLC's profits, which are only taxed once, and should therefore be avoided.

This belief is based on a misunderstanding of the pass-through taxation structure. Since few high-growth startups turn profits in their first few years, there is effectively nothing to "double-tax." Startups tend to reinvest any revenue they generate in growth, and no profits to tax means no tax on profits. No profits also means no dividends paid to shareholders, so there will be no personal tax on those nonexistent profits either. In other words, "double taxation" in a high-growth startup usually amounts to 2 x $0 = $0, or double taxation on nothing.

However, LLCs operating at a loss do offer their owners the ability to pass through some of that loss directly to their personal tax returns, thus reducing their net taxable income. This is genuinely attractive to many startup entrepreneurs, who are likely to be bootstrapping their businesses and forgoing a salary, and are therefore very grateful to reduce their tax burden.

Startup founders who are interested in taking advantage of pass-through taxation while still choosing the standard and well-suited C-Corporation structure for their startup can choose to elect S-Corporation status. There are two distinct disadvantages to this approach, one of which can be handled easily and one of which cannot be mitigated at all.

The first disadvantage is that S-Corporations are effectively investor-proof. S-corporations, as noted above, are limited to one class of stock and 100 individual shareholders (who cannot be businesses or partnerships). Still, an S-Corp is perfect for an initially founder-funded startup, and then when the startup's first investors arrive, the company can simply drop its S-Corporation election and turn into an investor-friendly C-Corp with the ability to issue the Preferred stock that they will insist on purchasing.

The second disadvantage is that an S-Corporation (as well as an LLC or any other non-C-Corporation entity type) is not eligible to take advantage of the Qualified Small Business Stock tax write-off, which can amount to millions and millions of dollars in savings.

QUALIFIED SMALL BUSINESS STOCK (QSBS):

A key consideration for everyone

Under certain circumstances, stock issued by C-Corporations counts as Qualified Small Business Stock (QSBS). After five years of ownership, the gains made on the value of this stock can be written off the personal taxes of the stockholder up to $10,000,000 or 10x the stockholder's adjusted basis in the stock, whichever is greater. In other words, the $10M in non-taxable gains is the minimum, provided you have $10M in gains in the first place.

The requirements for equity to qualify for the QSBS exemption are relatively straightforward: stock issued by an active, domestic, C-Corporation that has less than $50,000,000 in assets right after issuing the stock. Virtually all newly-incorporated, high-growth, US C-Corp startups would meet these requirements.

For both startup founders, who are expecting (or hoping for) a massively successful exit, as well as investors in such a startup, this $10M+ in tax exemptions should be an extremely compelling reason to choose C-Corporation status. After all, is the possibility of saving a small amount in taxes deducted from your personal income this year worth potentially paying taxes on up to ten million dollars in personal gains when you make it big?

The investor’s perspective

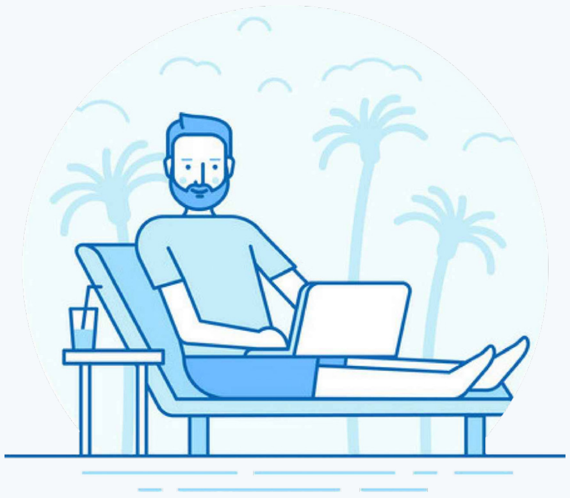
Like founders, investors’ primary cause of aversion to LLCs is the difficulty created by their non-standard equity mechanisms. Remember that since LLCs are technically always partnerships, any equity-like features need to be custom-written into the operating agreement each time they are issued in order to approximate the equity functions of corporations.

Sophisticated professional investors often have portfolios with dozens—or even hundreds—of companies. If an LLC is among them, investors are required to deal with these ad-hoc equity agreements on an individual basis. Even though these may look and behave similarly to stock in a C-Corporation, the reality is that each one must be treated separately because there are no standards. Compare this to the known and understood mechanisms of C-Corporation shares, and it’s easy to understand why investors prefer the known commodity: it’s less work for the investors and their lawyers, making these types of investments significantly more efficient.

It’s also important to note that the efficiency isn’t just a one-time benefit at the moment of investment. It remains a concern for the duration of the relationship as it impacts everything from additional equity issuances to investor protective provisions. The crux of this issue is the LLC’s mandatory IRS form filing, known as a K-1.

Recall that the LLC is invisible for tax purposes. In tax season, the partners (i.e. all equity-holders, including each of the investors) have to file a document with the IRS that explains the attributed income they received (whether or not they actually received any of it in cash) from the partnership. These forms are called K-1s, and they are not popular with investors.

If an investor held a stake in an LLC (i.e. was a partner) in any given year, the IRS requires that the file a K-1 in order to complete their taxes, so the investor’s tax filing can easily be blocked by a single company’s tardiness in distributing the forms. In other words, a startup founder can accidentally expose their investors to tax penalties for late filing, which is unlikely to have a positive effect on what should be a mutually beneficial, satisfying relationship.



Between the sheer annoyance of K-1s, the legal and accounting difficulties created by LLCs’ ad-hoc approaches to equity, S-Corporations’ inability to issue preferred stock or take investment from business or partnerships, and the $10M+ in potential tax exemptions available only to C-Corporations, professional startup investors almost exclusively choose to invest in C-Corporations..

Why Delaware?

Corporations (and most types of companies) are chartered by state governments rather than the federal government. Because Delaware is a small state, it developed a series of tax and regulatory laws (notably the Delaware General Corporation Law) and court systems that are more advantageous to the corporation than almost anywhere else in the country, leading it to be the most favorable place to incorporate for both companies and investors. It's a revenue win for them; a tax and regulatory win for companies.

The net result is that most **investors** will prefer to invest in startups incorporated in Delaware, since its laws and regulations are both familiar and preferable to professional investment groups and startup lawyers. In some circumstances, there are compelling reasons to incorporate elsewhere, but most startups stick with Delaware as "The First State" and file a foreign qualification form to operate in their own home state.

Benefits of incorporating in Delaware:

- Delaware's filing offices and court systems are prompt and offer good customer service.
- The state has predictable, well-developed corporate laws that experienced businesspeople and lawyers worldwide understand.
- The laws are the most business-friendly and protective of a company and its management and board of directors.
- As it grows with more board members and investors, a Delaware corporation offers flexibility for Board actions and shareholder rights.

5. How Incorporation Works

Incorporation refers to a charter granted by a governmental jurisdiction, in this case the State of Delaware, for a group of people to do business as a legal entity rather than as individuals. This involves filing a Certificate of Incorporation, which means picking a name, signing a document, and sending it to the office of Delaware's Secretary of State.

To actually draft and file the Certificate, a founder will need to engage a lawyer or legal filing service. Gust Launch's incorporation process is the latter—it is a quick and easy software experience that fills out and files the Certificate of Incorporation, using a set of documents which have been custom-tailored for use by high-growth startup companies by experienced startup lawyers.

As part of the incorporation process, companies authorize themselves to issue shares of stock. Most high-growth startup companies, including all those who use Gust Launch, authorize themselves to issue 10,000,000 shares, each at a par value of at least $0.00001.

Setting a company up with millions of shares lets the company give relatively small grants to advisors and employees. To understand why millions of shares are necessary, it's important to mention that most shareholder grants use **vesting**, which (in extremely simplified language) makes the shares available incrementally over time[4]. Startup grants often vest over 48 months, meaning that 1/48 of the shares vest every month. If a startup has 10,000,000 authorized shares and grants 0.1% to a new advisor, the grantee would have 10,000 shares, which is easily and meaningfully divisible by 48 (to ~208 shares per month). By contrast, if you authorized only 5,000 shares, an 0.1% grant would be 5 shares. This math doesn't work nearly as well, because a grantee cannot easily vest 5 shares over 48 months.

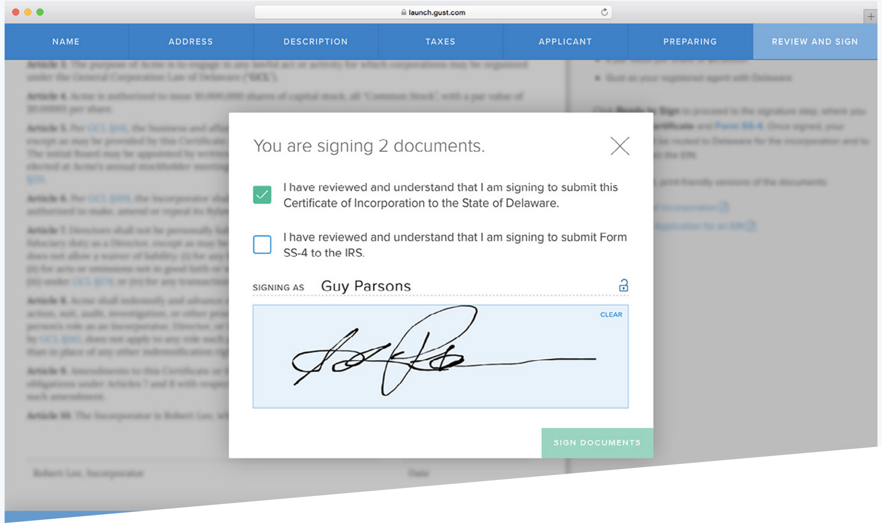
4 To learn more about vesting, read "**How Vesting Protects Companies and Founders**" on the Gust Launch Blog.

The per-share price (or par value) of $0.00001 is possible because the startup has no assets, so the taxes each grantee must pay on their stock grants can be kept extremely minimal by declaring an overall value of the company at $100.

Gust Launch's incorporation process also includes an SS-4, which is the application for an Employer Identification Number (EIN). This IRS-assigned ID number is used when paying taxes and otherwise identifying the company to the US government. It's necessary for opening a company bank account, as well as for paying employees when the company is ready to hire.

The Gust Launch incorporation process is quick and easy—to get started, visit **gust.com/launch** or watch a video demo at **http://gust.ly/incdemo**.

Watch a video demo of the Gust Launch incorporation process



6. How Company Formation Works

The term "company formation" refers to a series of decisions to make and documents and actions to adopt reflecting those decisions that ensure that the brand-new C-Corporation has the structure and traits that investors expect.

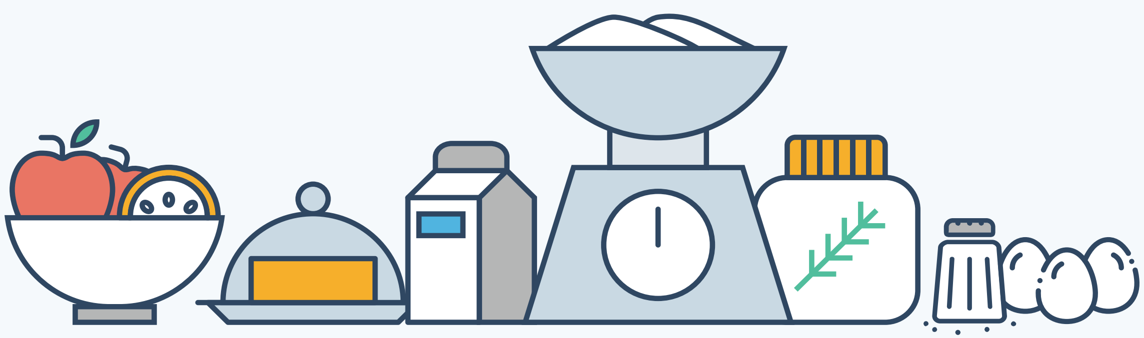
Some online incorporation services either skip the formation step or simply send the founder general-purpose documents that aren't appropriately customized for specific types of companies—for example, a family-run retail store would have very different formation documents than a venture-funded startup. Often, a startup will bring in an experienced lawyer at this point if they are using one of the more general-purpose online legal filing services.

We'll describe the Gust Launch approach, which takes the process step by step, using online documents specifically intended for startups.

STEP ONE:

Establish corporate bylaws

Immediately after filing for incorporation, a company needs to draft and adopt its bylaws. These are operating rules to specify the organization, structure, and governance functions of the corporation.



BASIC CATEGORIES OF BYLAWS

Stockholders:

people who own shares of the company have meetings and vote to elect Board members, among other things.

Board of Directors:

this section specifies the number of people on the Board, what their powers are, and the rules that apply to them.

Officers:

the organization's top management, what they do for the organization, and how they will be appointed. In the beginning, this might mean co-founders as well as any advisors or investors the company has.

Indemnification:

the corporation accepts the responsibility to cover legal actions brought against certain people who act on its behalf. In other words, if a founder or officer is sued, the corporation will pay the attorney fees and any damages assessed, rather than leaving the founder on their own.

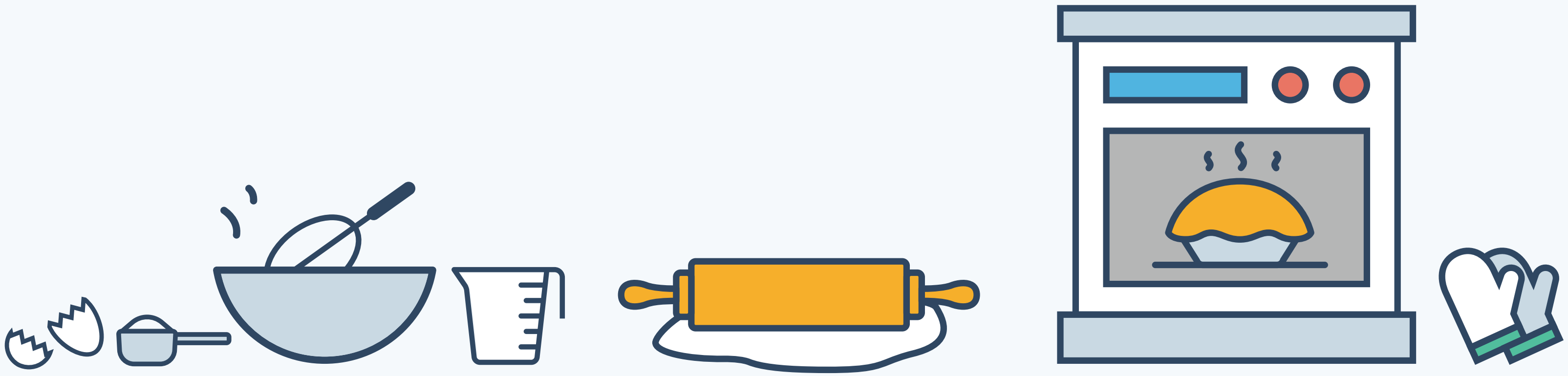
Stock:

how the company's stock ownership is tracked, including how the company records ownership, rights to receive dividends from the stock, and other specifications.

There are a few other pieces to the bylaws. Many will be different for startups than for other kinds of companies. For example, startups can save countless time and money by including provisions in their bylaws to take advantage of new Delaware laws that allow for paperless stock records and online votes and notices. This is one of many reasons to hire a startup lawyer or use startup-oriented legal automation software, such as Gust Launch, that use documents appropriate to startups.

STEP TWO:

Move from incorporation to ownership



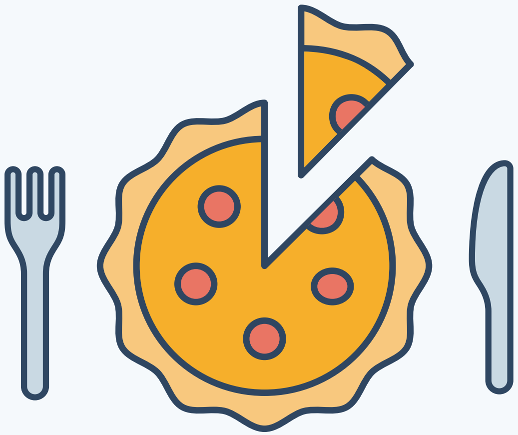
There are several ways to go about the next formation steps. Gust's process is optimized for simplicity and speed of execution.

In the incorporation process, the person signing and filing the Certificate with the state of Delaware is known as the "Incorporator," and has certain initial duties specified by the Certificate and by Delaware law. For convenience, Gust asks the primary founder to sign as Incorporator, and in that role to adopt the initial bylaws by signing an "Action of the Incorporator." By that document, the Incorporator also appoints the first Board members—in this case, appointing themself to be the first member of the Board, and then resigns as Incorporator (because the position has no further duties).

The new Board is empowered by the bylaws to appoint officers of the company. The next step is for the Board's newly appointed initial member to appoint the company's first CEO (usually themselves), secretary, and treasurer (the three "statutory" officer positions required by Delaware and the bylaws), as well as any other initial officer positions they wish to set up initially. The co-founding team are now the officers and Board of the company, but they do not yet actually own the company. In fact, nobody does. That's what shares of stock are for. The next step is to solve this problem.

STEP THREE:

Issue stock



Per Delaware law, the Board directs the issuance of shares of company ownership. The Gust Launch Certificate of Incorporation provides for 10,000,000 authorized shares of the new company, which just means that the company can theoretically be divided in up to 10,000,000 equal pieces. To create actual ownership, stock will have to be "issued," meaning that the company pushes out shares from being merely authorized to being actually outstanding, and then "granted," meaning that the shares are sold to one or more people or business entities. The initial stock grants will likely make up a significant but not complete portion of the 10,000,000 authorized shares, split among the co-founding team and any other initial participants[5].

Once the Board approves the initial stock grants, the CEO oversees and signs the issuance and grant of stock to each recipient, who will need to sign a package of stock grant documents and purchase the stock (at the nominal "par value" of $0.00001 per share specified in the Certificate of Incorporation) for the grant to be complete. Most companies with multiple founders and team members opt to make stock ownership subject to vesting. There is also a stockholder agreement to handle a myriad of terms that apply to stock ownership, like transferability of shares. This is the point at which the co-founders would file their 83(b) elections, which relate to taxation of future gains in value of vested stock.

Incorporation & company formation, step by step:

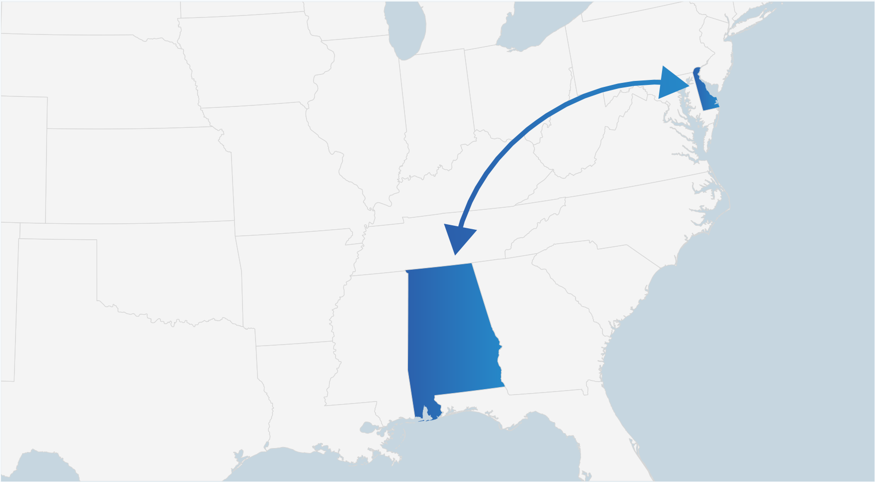
1. Obtain a charter by filing its Certificate with Delaware
2. Apply for and receive an EIN from the IRS so that it can open a bank account, hire employees, and pay taxes
3. Adopt bylaws containing the rules and structure that investors expect, and set out its operations and powers
4. Elect a Board of Directors
5. Appoint the founder and others to be officers
6. Issue and sell stock to founders, giving them ownership of the company

5 For more background on how this all works, check out **Gust's guide to startup equity terms and principles**.

7. Foreign Qualification

The last step of incorporating and setting up a company is only relevant to companies which incorporate in states other than the state in which they are physically located or active. In this case, a company will need to file for foreign qualification, which means submitting a document to the state in which they are actually based asking for permission to do business in that state.

In other words, if a company is based in Delaware but has its headquarters in Alabama, it will need to file a foreign qualification with Alabama in order to operate. This will inform Alabama of the company's existence, and gives that state the power to regulate and tax the company.



The actual document that must be filed varies from state to state (as does the fee which the company must pay to file it), but most states refer to this document as a "Certificate of Authority." The requirements of the application may differ but usually include a mix of information about your business (such as how many shares you've authorized) and sometimes a certification from your state of incorporation called a "Certificate of Good Standing" that attests that your business conforms to local laws.

The fee is generally a flat rate, and for the most part, this fee is not especially substantial: it's on the order of a few hundred dollars. However, in a few states, the burden can vary greatly, especially for high-growth startups. For example, in Virginia, the fee is calculated on the basis of the number of authorized shares, which results in a fee of over $2,500 for startups with 10,000,000 shares. Nevada, on the other hand, calculates its fee according to the value of the startup's equity using a minimum par value of $0.001 per share, which ends up putting the fee for new startups with 10,000,000 shares at around $75.

Actually filing for foreign qualification is as simple as looking up the forms for the state in which you wish to qualify, filling them out, and sending them in. However, due to the variant nature of the fees (and forms), consulting a lawyer about this process is often advised. A Gust Launch subscription includes the process of foreign qualification and files the appropriate documents on its startup's behalf, leaving founders responsible only for the fees charged by the state as well as a small filing fee charged by our filing partner, which depends on the state in which you wish to qualify.

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ABOUT GUST

Gust is the global SaaS platform for founding, operating, and investing in scalable, high growth companies. Gust's online tools support corporate legal and financial formation and operation for entrepreneurs, as well as deal flow and relationship management for investors, from startup through exit. As the world's largest community of entrepreneurs and early-stage investors from 191 countries, Gust pioneered the equity funding collaboration industry and is the official platform of the world's leading angel investor federations and venture accelerators. More than 500,000 startups have already used Gust to connect with over 70,000 investment professionals. Gust powers the official online hubs of the world's largest innovation ecosystems including New York City (**Digital.NYC**), Boston (**StartHub.org**) and London (**Tech.London**). For more information about Gust, please visit **gust.com**.

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