



Lowenstein Sandler's Emerging Companies, Venture Capital Podcast: The Founder Hour

Episode 1

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MARCH 2026

Eric Weiner: Hi, everybody. Welcome to *The Founder Hour*, from Idea to Exit, Happy Hour Conversations on Forming, Growing, and Selling a Business, a Lowenstein Sandler podcast series. I am Eric Weiner.

Laura Cicirelli: And I'm Laura Cicirelli.

Eric Weiner: We're partners in Lowenstein's Emerging Companies and Venture Capital Group. Whether you're forming your first company, negotiating your first term sheet, or preparing for an exit, decisions you make early can shape your company's future.

Laura Cicirelli: Each month, we bring the conversations happening at our New York office to the broader founder and investor community, sharing practical, legal, and business insights to help you navigate every stage of your company's growth.

Today, we'll be discussing company formation. Choices that you make at the beginning, your entity type, your timing, your tax structure, your ownership setup, can either accelerate your growth or quietly complicate every round that follows.

Today we'll break down how to choose the right entity structure for where you are and where you're going, when it actually makes sense to form a company, key tax considerations for founders, and how to build a legal and financial foundation that stands up to venture capital scrutiny.

Whether you're still at the idea stage or preparing for your first institutional check, this episode will help you avoid costly missteps and position your company to scale with confidence.

Laura Cicirelli Alright, so for formation, I think we should start with just 3 general baskets of stuff. I think entity type and timing, IP ownership, and just co-founder relations are the three baskets that we want to talk about. We'll get started on the first with entity type. I think the two different

types that you see the most are LLCs and C corporations. And it is funny because I always remember growing up this connotation of C-corporations as being double taxation and negative connotation, but in our world, when you're going to have venture-backed financing, C-Corp is really the way to go.

Eric Weiner:

Yeah, C-Corp is definitely the most standard entity type for a startup company that believes it's gonna be venture-backed at some point in the future. The first thing we usually ask our clients when they're forming a company is, like, what type of company do you want? Do you believe you're going to be a venture-backed business, pursuant to which, you know, maybe you're not going to make a ton of profit to start, but in five or six or seven years from now, you're gonna sell the business, and you're gonna, you know, hopefully live on an island somewhere because you've made a ton of money, or are you gonna form a lifestyle business, pursuant to which maybe it's the type of business you're gonna run for the next 25 years of your life. And you're gonna wanna use the profit every year from that business, to make a lot of money. And the best way to do that would be through an LLC structure because if you're really in a lifestyle business, and you're gonna distribute profit to yourself or your, you know, your members throughout the life of the business.

Laura Cicirelli:

Or take the losses.

Eric Weiner:

Or take the losses. It's a pass-through, and you only get one level of taxation. And for those types of businesses, that's a great, great way to go because you keep most of the money in your pocket. We know that's pretty much what everybody is hoping to do. What LLCs don't have, at least at the outset, and we will talk about this in greater detail at a later *Founder Hour* podcast, is the benefit of qualified small business stock.

Laura Cicirelli:

So, qualified small business stock, what is it? So, it's a big tax-saving benefit to shareholders of a C corporation. And so, if you receive equity from a company directly, and, you hold that stock prior to July of 2025 for a five-year window and, you know, the assets, the book assets of the company are \$50 million or less, you get, upon the sale of that stock, assuming you held it for the five years, you get the benefit from federal tax savings of the greater of \$10 million or 10 times your basis. After July 4th of 2025, that became even better, where it became the greater of \$15 million or 10 times your basis.

Eric Weiner:

And the holding period changed. So, where you used to have to hold it for five years, now it's only three years, but there's step up in exclusions. So now, if you hold your stock for three years, it's \$7.5 million or 10 times your basis; four years, \$10 million or 10 times your basis; five years, \$15 million or 10 times your basis. So, it's really an amazing, amazing tax law, and it's a great thing for founders. Also, the \$50 million gross asset test has moved up to 75. Very briefly, we will say, you know, prior to July 2025, you know, when we would talk to clients about forming and they wanted to be an LLC, we would express there's a little bit of danger in forming as an LLC because you don't get the benefit of a qualified small business stock and your holding period doesn't start unless and until you convert from an LLC into a C-Corp. Now, you can get a benefit because you get a step up in basis when you convert to a C-Corp, but, if you have to wait another five years if you convert, you're taking a risk that you'll never get the benefit. That has changed since July because now the holding period is shorter. So, while we would still generally say, if you're going to form a startup company, a C-Corp is the right way to go. It is easy, it is what we do every single day, what most founders do. You should definitely have a discussion with your advisor, whatever counsel you're using to form the business, about what makes the most sense for you because now that you only have to hold for 3 years post-conversion, you know, it could end up actually benefiting you greater in the long run.

Laura Cicirelli:

Yeah, and I think it's helpful to note that when we talk about the, you know, pre-2025 regime, it's not when the company was formed. It's when you received the actual equity. So there could very much be a situation, and often there is, where a founder receives shares at formation, and that was pre-July 4th of 2025, and those shares are subject to the prior regime when they're sold, and, you know, you get a top-off grant or additional shares in the future post-July 4th, 2025, and those would be subject to the new regime.

Eric Weiner:

That's a great point. So, you know, pound for pound, you know, the first choice you need to make is whether you want to start as: an LLC, a C-Corp lifestyle business; LLC non-lifestyle business; most likely a C-Corp, possibly an LLC, but again, that's for a conversation you should have with your advisors before you hit any button on an entity. Now that we've talked about entity type, timing of formation is really important. First of all, if you think about the QSBS step we were just

talking about, holding periods matter. So, you know, if you have an idea, it's pretty easy nowadays to get a company set up so there's no real problem in planting your flag and getting your equity. But the bigger issue that we see founders run into, and this is a pleasant problem, is oftentimes you have an idea, you're working on the business, maybe for months, maybe for a year, and you bake this idea into something that's real, and you start having investor conversations. That's great.

The problem with that could be is you get a term sheet before you form a company. You're in a much better position if you form the company before you get a term sheet. Because when you buy your founder shares, which are basically shares of common stock, you're gonna pay a very low price for those shares. And if you have a term sheet that tells the world that the price should be a lot higher, you know, the IRS may have something to say about that and future investors may have something to say about that in diligence. So, timing is very important.

Laura Cicirelli: Yeah, I think another timing consideration, especially, I know we'll get to co-founder relations later in the podcast, but if you're working with one or two other co-founders, and you're all working on this idea, and without the company being formed, you each individually still own all of those ideas. And so you want to make sure, if you're going to form a company with these individuals, that you form it as soon as possible, and have everyone assign their IP over, and I know we'll talk about that next in more detail, but you want to get that done ASAP, so there is no risk of one of these founders leaving or deciding to branch off and form their own company when the intent was for you guys all to work together on this endeavor.

Eric Weiner: Yeah, I think that's another great point, Laura. We do from time to time see companies say, you know, "We have two founders, and we're waiting for our third co-founder, who's going to be the CTO, or the technical founder." It is harder to get a later founder equity at the same price as the original founders if between those two things, the company has raised money. And what Laura was alluding to, which is extremely important when you form a company, is when you get your founder shares, you're buying them for cash, a low amount of cash, think like 100 bucks or so, plus all the stuff in your head, which is the ideas and all the stuff you've created for the company. So, effectively,

you're paying in full for your shares with your cash and your ideas. If later someone comes in and all they have is cash, they might not be able to pay the full price, and that could potentially lead to a tax complication. We will get into the details of that probably a later podcast, but you really want to try to get everybody on the team at the same time before you get a term sheet so that you take away these complexities. The great thing is that we do run into these issues quite often, and there are things that can be done, but you're trying to streamline your formation process. And one of the great things about forming a company nowadays is that it's kind of easy, and it can be done quickly and inexpensively, so any sort of complexity you can take out of it, take out of it.

Laura Cicirelli:

Yeah, we're using the term IP, or intellectual property, a lot here, but I think that for those that don't practice, when they hear IP, they think of patents, trademarks, copyrights, things that are registered a lot of times, and that's not what we're talking about here. We're talking about just, you know, trade secrets, ideas, thoughts about the company and what the company wants to do. So, it's a very loose term when you say IP and the documents that are put into place at formation to assign from the founders their IP to the company, it defines these things very loosely, so it covers all of those things. And we spoke about, at formation, getting your equity for partly IP assignment and a purchase price, but there's kind of two things I think of when I think of founder IP.

One is everything up to date as a formation when I purchase my shares, everything that has happened in the past being assigned over as consideration. But then I also am going to sign something that on a go-forward basis as I continue to work for the company and develop IP related to the company, that all also gets assigned over to the company. And that's not just a founder concept, that's going to happen and that's going to exist anytime you hire a service provider. And it doesn't matter if they're an employee, advisor, or consultant. There will be or should be, intellectual property assignment language, that everything you do relating to this company needs to belong to the company. And that's super important to have. Any investor that's going to come and put money into your company, sophisticated investor, is going to look at this documentation and make sure that that absolutely is in existence. I think when we represent investors, which I

do quite often, the number one thing I look for is IP assignments after you make sure that that cap table is, you know, accurate and all of the shares are properly noted. Those are definitely things that investors care very much about.

Eric Weiner: And it's something that we do see, you know, a common mistake that founders can make is, you know, "Hey, you know, I was having I got a college friend of mine who's a technical person, they were just doing a little work for the company, never signed anything, but really, really nice person, you know, it'll be fine." Unfortunately, that arms that person with a lot of leverage that if you are going to be a financially venture-backed business, and they see that what they've contributed or created is worth value of some sort, they're probably going to want extra value, and to Laura's point, it is Diligence 101. Your investors are investing in your company because of your special sauce. Your special sauce is the ideas and the IP and all the other things that you and your service providers are creating for the business. So, you assign everything you've thought about leading up to the creation of the business, and then on a go-forward, you and everyone who ever does anything for the business, before you let them do a thing, they should sign something that assigns the IP that they are creating for the business to the business. If it doesn't have it, it is devalued.

Laura Cicirelli: Yeah, absolutely. And I think, you know, this is all soft IP we're talking about, but a lot of times at formation, we do talk about registered IP, especially trademarks, when it comes to branding your company. And a lot of times we have founders come to us and say, you know, "I want this name. Can you search and make sure it's available? It's very important to me." And in those situations where a client is passionate about a name, wants to rely on that name for branding purposes, the next conversation we have with them is not only form the company using that name, but do you want to make sure that you have the trademark available for that name so that the company owns it, you're able to trademark, and hold yourself out to the public with that brand name.

Eric Weiner: Yeah, and even domain names.

Laura Cicirelli: Domain names.

Eric Weiner: And, you know, some people, while you don't need the name of your, like, the Delaware name of your company to be the brand. You know,

it's a little easier when those two things match. It's not, it's definitely not necessary. We have plenty of companies that Eric and Laura co- and then have are out in the marketplace as something else. That's fine. It just does add another thing. So, if you're thinking of forming a business, you fall in love with a name. You know, take a look if that name's available.

Last very quick point on IP for all you students out there who are forming companies or in some programs at your universities and potentially forming into arrangements with those universities regarding what you're creating or a patent or something, it's very important that before you sign any agreement with the university, that you have sophisticated counsel take a look. You want to make sure you understand who owns the patent, what portion of the patent, what equity the university may be entitled to, and that's also, you know, something that investors, when they look into business, if they know you're coming out of a university, will ask about and want to know what the details are.

Laura Cicirelli:

Yeah, I think this is a super prevalent point now. I think so many colleges, law schools, they have these entrepreneurship programs, clubs, even minors. So, and one of the final projects is creating something, and so you want to definitely make sure that you know who owns that thing that you're putting this time and energy into creating.

So, I think the last topic that we want to talk about is just co-founder relations, and we kind of covered it elsewhere in this podcast when we talked about timing and making sure that any co-founders also have their IP assigned to the company, and, you know, getting that third co-founder who may be your CTO on board, but I think whenever I think of co-founders, and I talk to founders who are forming a company, I talk about vesting, and it's super important. So, it's kind of often referred to as, like, a prenup amongst you and your co-founders. You want to make sure that there is comfort because when you form the company, obviously everyone's excited, everyone's happy, everything's great. But what happens in a year when one co-founder wants to leave and goes to a remote island, can't be contacted, and wow, they hold half of my company. That's never ideal. So, what vesting does is everyone, as of day one, whatever shares you're issued at formation, even if they're subject to vesting, you own those shares.

You get to vote those shares. The difference is they're subject to risk of forfeiture, which means that if you no longer are providing services to the company, and some of those shares are still subject to vesting, the company has the right to repurchase those shares and they go back to the company. You no longer hold those. So, while it may have been a 50-50 split between two co-founders, if one co-founder has left halfway through their vesting schedule, it's going to be 75-25. And so, the most common vesting schedule we see in our world is four-year vesting with a one-year cliff. And so people say, you know, what exactly does that mean?

That means that it is a four-year vesting period total. For the first year, nothing actually fully vests. On the 12-month anniversary of the vesting date, 12-month worth of the vesting, then fully vests and is, you know, yours, no longer any risk of forfeiture. And then on a go-forward basis for the next 36 months, there'll be 36 equal monthly installments of vesting for your shares that you hold.

Eric Weiner:

Yeah, for sure, and look, we very often see founders who have been working on the business for a year, actually doing real stuff. They just never, you know, called the lawyer, or they informed the company, but they've actually been, you know, effectively running a company for a year. So, what we do see quite often is four-year vesting, but you get credit for the year, in that instance, that you've been working on it. So, you'd have, you'd already be at your cliff by the time you got to formation. But the prenup point I think Laura made was great. It's always good to come to these types of agreements when you love each other, versus when you don't. And, you know, unfortunately, you know, not every founder relationship works out, so we very rarely see, and, you know, you don't necessarily need, like, a founder's agreement, pursuant to which you have some stockholder agreement as between you and your co-founders, number one; can add friction into the, you know, the beginning of the company where, again, we're talking about loving each other. And two, it's an expense you probably don't need to pay at this early stage because when and if you are venture-backed and you do a deal with, you know, investors, they're gonna have brand new stockholder agreements and that agreement's gonna be ripped up. So all you will have done is potentially, added some friction into the relationship and spent some money that you

didn't spend. But vesting is absolutely essential when you are a multiple founder company.

Laura Cicirelli: Yeah, and I think, you know, we talk about vesting when it comes to co-founders, but it's not a concept that's exclusive to co-founders. Anytime you bring on a service provider to the company, you're also going to subject them to vesting because very much in the same way, you want to make sure that you get along together, this is a good arrangement, before you just issue someone one percent of your company.

Eric Weiner: And that's why the cliff is so important because, you know, if you hire a service provider, the reason why you have the cliff is you know, maybe after three or four months, you realize it's just not the good hire, and he or she is just not going to work out, and probably shouldn't get that equity, and it gives you time, you know, to figure that out and potentially, you know, end that relationship, but if someone gets past the year, presumably they've done a pretty good job, and you think that they're worth it, so that's when the vesting changes to monthly.

Laura Cicirelli: And the cliff is going to be for employees, right? Because those are the people that you envision having a longer-term relationship with. Advisors and consultants, they can have cliffs, right? They're usually a shorter period of time, three months, something like that. But advisors and consultants are usually shorter-term arrangements and, you know, sometimes project-based, so the cliff doesn't necessarily make the same sense.

Eric Weiner: Nor does the four-year term, right? Because, you know, hire a consultant for a year and then tell them they're gonna get four-year in vesting, I don't think they're going to be too keen on that.

Laura Cicirelli: Absolutely. I know this isn't a tax podcast, but before we move on and end the episode, when we talk about vesting, we have to talk about, quickly, just 83B elections and what that is. And a lot of times, we have founders come to us after they form their company, and they kind of give us all their documents that they used, some program to, you know, help them create their company, which is fine. But then they give us an 83B election that they filled out but never filed with the IRS. And so, what is that? So, when you form a company, and you're getting restricted stock subject to vesting, whenever there's stock with

a risk of forfeiture, you should file an 83B election. The idea is for your company to go up in value over time, and your shares to increase in value over time, and so what the 83B election is doing is saying, you know, within 30 days of your receipt of the restricted stock, you file it with the IRS saying, I want to pay all of my taxes on these shares now. Even though they're subject to vesting, I want to pay all of my taxes now.

Eric Weiner: Which should be zero.

Laura Cicirelli: Which should be zero.

Eric Weiner: Because you're paying full price.

Laura Cicirelli: Yeah, exactly right. So that's why we recommend everyone file it.

Eric Weiner: If you're a founder forming a business and you're subjecting your shares to vesting. You should file an 83B unless you have an advisor give you a very specific reason not to. And it's 30 days. You can file it electronically. Both your accountant and your lawyers will be able to help you do it and explain to you exactly how to get it done. Candidly, if you do it with us, we will be emailing you every few days to make sure you did it because it's an important thing. There are things you can do to remedy a late filing or a lack of a filing but none of them come without some potential pain. Delaware law gives us a lot of ability to, you know, fix things. 83B is not one of those things, it's not a Delaware law issue, it's a tax issue, so very glad Laura brought it up. Your co-founders, you're vesting, 83B should be on your mind, ask your lawyer about it, ask your accountant about it, but it's an easy thing not to mess up, but it gets messed up.

Laura Cicirelli: Yeah, and like you said, you can do it online. That's a new, I think it was in the last year that came about, and so there's really no excuse to not do it now. You can do it in minutes.

Eric Weiner: And keep a record of it because there's a few things that we've mentioned on the call today about Diligence 101. This is another Diligence 101 question, like, "Did the founders file 83Bs?" And if the answer is no, it's why, and we have a longer discussion with investor council about why.

Laura Cicirelli: Today we talked about a lot of different topics at a high level. You know, entity formation and timing, intellectual property, vesting, co-founder relationships. You'll see that, you know, as we continue this

podcast, these topics will come up in a lot of different areas. Like we kind of preview now with hiring people, and, you know, when you sell the company, what happens if some shares are subject to vesting? We'll revisit these topics again, but I think this is a good foundation for people to just get to understand these topics at a high level.

Eric Weiner:

Yeah, and in future *Founder Hour* sessions, both in person and on podcasts, we will hit a lot of similar topics in detail. This is just the, you know, the first one, introduction, sort of the 101 course in forming a company, what are the quick hit things that I need to know. Obviously, if you have more questions about these details. You can call Laura or me, we're easily found, and, you know, hopefully we will get to see you at *Founder Hour* sessions in the future.

But for now, thank you for listening to the two of us talk shop, and looking forward to the next one.

Laura Cicirelli:

Thanks, everyone.

Eric Weiner:

Thank you so much for joining us for *The Founder Hour*. If you enjoyed this episode, be sure to subscribe on Apple Podcasts, Spotify, YouTube, wherever you listen so you don't miss future conversations.

Next time we'll be discussing early-stage funding considerations, safes, and convertible notes. If you would like to join *The Founder Hour* events live in our New York office, you can contact TheFounderHour@lowenstein.com for details. You can also contact Laura or me. Our next event will be held on March 25th from 6 to 8 p.m. Until then, thanks so much for joining us.