

Entity Choice in the Life Sciences Industry: A Tax Perspective



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For companies in the life sciences sector, choosing the right legal structure for your business is a critical step with lasting tax, fundraising, and strategic implications. Whether you're launching a biotech startup, developing a new medical device, or scaling an established pharmaceutical company, your entity choice can impact everything from how you raise capital to how your company is taxed and what liability protections you receive.

Below, we outline the key entity types commonly used in the life sciences industry, along with their tax advantages, limitations, and strategic considerations.

Single-Member LLC

A single-member LLC is a simple, flexible structure for businesses with one owner. It is typically treated as a disregarded entity for federal tax purposes, meaning the business's income and expenses flow directly through to the owner's personal tax return.

Tax Considerations

- No separate federal income tax return is required (unless the business has employees or excise tax obligations).
- An Employer Identification Number (EIN) may still be required.
- SMLLCs may qualify for the federal research credit, which supports companies conducting qualified R&D in fields like biotechnology, engineering, and physical sciences.

Fundraising & Liability

- Funded through personal assets, loans, or grants.
- Provides liability protection for the owner.

This structure is often used in the early stages of a company's development before additional investors or owners come on board.

Partnership

A partnership involves two or more owners who agree to carry on a business for profit. Like a single-member LLC, partnerships are pass-through entities for tax purposes.

Tax Considerations

- The partnership files an informational return, but the income is taxed at the partner level.
- Partnerships can allocate income, deductions, and credits to maximize tax efficiency across partners.
- Partners' tax basis (i.e., their investment in the partnership) changes with liabilities and contributions, which can affect how distributions or losses are treated.
- The research credit is passed through to partners in proportion to their ownership.

Fundraising & Liability

- Can be funded similarly to single-member LLCs with personal assets, loans, or grants, in addition to equity and admission of new partners.
- General partnerships may expose partners to liability; limited partnerships and LLPs offer more protection.

S Corporation

An S Corporation is a tax election made by a qualifying domestic corporation that allows income and losses to pass through to shareholders for federal tax purposes, but offers some aspects of a C-Corporation structure.

Tax Considerations

- Avoids corporate-level taxation.
- Potential savings on self-employment taxes for shareholders.
- Shareholders must receive a reasonable salary for their work within the S-Corporation.
- Shareholders are taxed on their share of income relative to their ownership percentage regardless of whether distributions are made.
- The research credit is passed through to shareholders in proportion to their ownership.

Limitations

- Only U.S. citizens or residents can be shareholders.
- Cannot exceed 100 shareholders or issue more than one class of stock.
- Venture capital and foreign investment are generally not permitted.

Fundraising & Liability

- Limited in fundraising flexibility due to shareholder restrictions.
- Offers limited liability protection, important for companies exposed to regulatory or product-related risks.

C Corporation

The C Corporation is the most common structure for high-growth life science companies, particularly those seeking venture capital or preparing for IPOs.

Tax Considerations

- Pays a flat 21% federal income tax rate.
- Subject to double taxation: profits are taxed at the corporate level and again when distributed as dividends.
- Eligible for a range of deductions and credits, including the research credit and the general business credit.
- Required to make quarterly estimated tax payments if tax liability exceeds \$500.

Key Advantage – Section 1202 Stock

C Corps can issue Qualified Small Business Stock under Section 1202, which allows eligible shareholders to exclude up to 100% of capital gains from the sale of stock held for at least five years. This is a significant tax incentive for investors and founders in the life science industry.

Fundraising & Scalability

- No restrictions on number or type of shareholders.
- Can issue multiple classes of stock and offer equity-based compensation to employees.
- Preferred structure for raising venture capital and issuing stock under SEC regulations.

Governance

- Must maintain a formal structure with a board of directors and corporate officers.

Final Thoughts

For life sciences entrepreneurs, choosing the right entity structure is about more than just legal formalities – it can shape your company's funding options, risk exposure, tax liability, and long-term growth.

Before making a decision, consult with tax and legal advisors who understand the unique needs of life sciences businesses. The right structure today can lay the foundation for tomorrow's breakthroughs.