

# THE INTERNATIONAL

## DEALSHEET

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**WHITE SUMMERS, LIQUIDITY CLUB, AND SILICON VALLEY BUSINESS SCHOOL ARE PLEASED TO PRESENT OUR 2ND EDITION OF THE INTERNATIONAL DEALSHEET.**

We know, it's been a year since we put out Edition 1 of The International DealSheet (FKA "White Summers International DealSheet"). There's a good reason for this. We've been super-busy building content for our sister company [Liquidity Club](https://liquidity.club/) which is our SAAS platform for taking scaling mid-stage startups to liquidity events...consisting of funding, revenue expansion into new markets and exits (check out <https://liquidity.club/>). Given the tight connection and content contributions to The International DealSheet by and between [White Summers](https://www.white-summers.com/) (<https://www.white-summers.com/>), [Liquidity Club](https://liquidity.club/) and [Silicon Valley Business School](https://svbs.co/) (<https://svbs.co/>) we've tweaked our sponsorship to call out these 3 major partners.

So here we are again with our spin on the hottest topics in global tech (yes, global tech is still a thing). The DealSheet covers dealmaking everywhere, real-time with a focus on transactions, startup operational issues, dispute resolution, IP ownership, financial / tax development, and the tech exit process. Basically all you need to know on current trans-border dealmaking around the world. New editions of the DealSheet will circulate every calendar-quarter consisting of short articles from all of us – and all of you! Contributions, submissions, observations, comments, and alternative views are welcome. Contact our editors Mark White (White Summers) at [mwhite@white-summers.com](mailto:mwhite@white-summers.com) and Scott Axelrod (Liquidity Club) at [scott@liquidity.club](mailto:scott@liquidity.club).

### WHY ARE WE RESTARTING THIS?

Because notwithstanding all that's happening in the world right now, trans-border deals are still getting done, standards are changing rapidly and the old rules of structure and process are, well, old. With the rise of nationalism, tariffs, currency controls, uniform tax movements, and regulatory oversight there are new ways to do business that must be considered.

IF YOU LIKE WHAT YOU READ HERE THEN IT WILL BE EVEN BETTER WITH YOUR SUBMISSION. IF YOU DON'T THEN HELP US MAKE THIS BETTER. YOU'LL GET PUBLISHED IN THE DEALSHEET, POSTED ON THE LIQUIDITY CLUB PLATFORM AND GET A NOD ON ALL OF OUR SOCIAL MEDIA ACCOUNTS. WITH FULL ATTRIBUTION TO YOU AND A SHOT AT HOSTING FORUM EVENTS ON THE LIQUIDITY CLUB PLATFORM. PRETTY COMPELLING, WE THINK!

And now...here's what you'll find in our 2nd Edition!

- Topic One: Venture Studios Eat VCs
- Topic Two: Profits Interest are Cool...Options Not!
- Topic Three: Delaware No More!
- Topic Four: Workarounds Regardless of Who Wins the Election
- Topic Five: Taiwan – Business Lessons from Ukraine

# TOPIC ONE – VENTURE STUDIOS EAT VCS

It's true, there are now over 800 venture studios globally with half of these in the US. As background, Studios are industry-specific "factories" founded by Operators that conceive solutions which are divested into majority owned Portfolio Companies whose products and solutions are typically presold or vetted by leading industry Strategics. These Strategics invest in the Studio and identify products and services that they themselves will buy, use and make available to their end-use customers. Non-dilutive capital for Studio operations and Portcos come from a captive Studio Fund. The Studio model overcomes many of the failings of stand-alone tech companies including (i) lack of business diversification, (ii) a finite corporate lifecycle, (iii) constant need to source talent and capital from external sources that consumes executive time, (iv) unclear product-market fit in the early stages and (v) long odds of completing a successful exit that returns capital and to stakeholders.

Unlike stand-alone companies Studios are evergreen. US Studios typically focused on single industries and consist of (1) a Management Services LLC that controls the Studio and (2) is the parent of an Operations Company, Inc. subsidiary formed as a C Corp for tax purposes that provides functional back-office services to jumpstart Portco operations; (3) a dedicated pool of talent that constitutes a "Collective" of industry executives from which the Studio derives new product ideas and talent for portfolio companies; (4) a dedicated venture capital fund ("Studio Fund") that invests in (5) Studio portfolio companies ("Portcos") created by the Studio based on ideas and solutions sourced from the Collective. The process flow is: First - ideas come from the Studio founders, investors and the Collective; Second – the Studio then creates Portcos to exploit the most promising ventures; Third – the Portcos are then funded by the Studio Fund; and Fourth – industry corporates / strategics ("Industry Strategics") invest either directly into the Studio (Management LLC) or into the Studio Fund. Further, the Industry Strategics either (A) purchase and put into market the Portco products / solutions and in many cases and/or (B) acquire the Portcos whose products the Strategics purchase and use. Studios are perpetual motion machines with the hardest part at the front end building the Studio and getting it going. It's not easy.

From a legal standpoint here's what you need to think through when working with Studios:

1. Studio Conflicts Are Everywhere – including (i) managing competing Strategics that are working together in the Studio, (ii) balancing potential adverse interests of the Studio Fund and Portcos in the Studio, and (iii) the Studio acting in its dual role as GP of the Studio Fund and as the primary stockholder in Portcos. Clear rules of engagement for all Studio participants are required.
2. Minimizing Studio Dilution with Growth – the Studio founders need capital for Studio operations, for the Fund and for Portcos before the Fund is created. The trick is raising non-dilutive capital through the Fund or directly into Portcos but not IN the Studio.
3. Governance – Studio success is heavily dependent on who makes the decision on what ideas are good, what Portcos are created, what management teams are hired, what does the Fund invest in and under what terms – and who makes judgement calls in the event of conflicts. All of this must balance the often divergent interests of the Studio founders, Strategics, Fund LPs and Portcos.
4. Getting Started – as the core business of Studios is to conceive of, create and derisk operating Portcos, starting with the creation of 2 or 3 initial Portcos is the logical starting point. The Studio infrastructure can then be built around the Portcos, first with creation of a Management LLC to hold Portcos equity rights, then with formation of an Operations Company followed by a Studio Fund – typically after the successful of initial Portcos can be tracked. Funding the Management LLC enables Studio operations and Portco support.

## Topic References:

1. This Applico article dives into the specific differences between venture studios and traditional VC models, highlighting the advantages studios offer (<https://www.applico.com/blog/what-is-a-venture-studio/>)
2. Signature Block provides a detailed comparison of the venture studio model and the VC approach, focusing on areas like investment strategy and level of involvement (<https://www.signatureblock.co/articles/venture-studios>)
3. This Medium piece delves into the operational aspects of venture studios, explaining how they create and launch companies compared to traditional VC investment methods (3. <https://medium.com/@bergen.maddy/venture-studios-are-redefining-the-startup-landscape-0e3aff0f3dcd#:~:text=Unlike%20VCs%2C%20which%20typically%20invest,often%20acting%20as%20co%2Dfounders>)
4. This YouTube video features Marc Wesselink, an entrepreneur with experience in both accelerators and venture studios. He discusses the key differences in their approaches to building startups (<https://www.youtube.com/watch?v=9Uxb0LUDZFE>)
5. This Venture Studio Index article explores the potential collaboration between venture studios and VCs, showcasing how they can work together to achieve successful exits (<https://www.venturestudioindex.com/>)

## TOPIC TWO – PROFITS INTEREST ARE COOL... OPTIONS NOT

Options are not easy. They must be priced at market value on grant, stock purchased under options must be paid for, options cashed out on exits are taxed at compensation rates, and options are capital rights that complicate the cap table. Is there a better way to issue equity rights in tech?

Look no further. For US limited liability companies (LLCs) consider “Profits Interests” (PIs) which, suddenly, are all the thing. Why? Because, as a right to profits which is not a capital right (like stock and options) Profits Interests (i) require no buy-in; (ii) PIs are not taxable at grant or upon vesting and (iii) profit distributions prior to a Company exit are taxed as dividends or upon an exit are taxed as capital gains, not as ordinary income. This favorable tax treatment applies not only in the US but in most other countries as well. And there’s more: (i) PIs don’t need to be priced on grant, (ii) PIs don’t need to be exercised with payment to acquire an underlying security, and (iii) in the event of the holder’s termination of employment PIs simply expire without need of the Company to repurchase the interest.

But here’s the rub. PIs can only be issued by pass-through entities taxed as partnerships, like LLCs, Partnerships or Limited Partnerships. And for US tax residents, units issued in LLCs are not eligible for QSBS (Qualified Small Business Stock) treatment under US-IRC Sec 1202 (which if held for 5 years entitles the holder to an exclusion from federal tax equal to the higher of \$10M or 10X the purchase price of the QSBS). This is a major reason why institutional investors in startups prefer investing in C corporations, as this is the only corporate form in the US allowing for QSBS. Given this, how can a holder get the dual tax benefits of both PIs tied to units or partnership interests and QSBS tied to stock issued in US C-corporations?

One approach is to create two separate companies consisting of an LLC holdco parent and INC subsidiary. The INC subsidiary conducts business operations including employing staff, selling and supporting customers, invoicing and collecting customer revenues and retaining earnings for future working capital taxed at lower corporate rates. Prior to an enterprise sale any excess cash in the INC not retained for working capital can be distributed as a dividend to the LLC parent and passed through to the LLC owners – allowing for liquidity prior to an exit. Upon an enterprise sale both the LLC and INC are then sold to the Buyer with the purchase price mostly allocated to the purchase of the INC with proceeds paid to the INC stockholders applied against their QSBS federal tax exclusions. As the business scales and adds new employees, incentive compensation in the form of PIs can be issued through a PI Reserve Pool in the LLC. In this way interests to new employees are not priced and securities are not acquired and paid for, and profits distributions enjoy favorable tax treatment.

### Topic References:

1. This National Law Review article specifically addresses the tax advantages of profits interests compared to stock options for US limited liability companies ([https://parsonsbehle.com/images/pdfs/should\\_my\\_partner\\_be\\_my\\_ceo.pdf](https://parsonsbehle.com/images/pdfs/should_my_partner_be_my_ceo.pdf))
2. JPMorgan Chase’s Investopedia offers a clear comparison of profits interests and stock options, highlighting the ownership rights and tax implications for each (<https://www.investopedia.com/terms/p/profits-interest.asp>)
3. LegalZoom provides a breakdown of how profits interests work in LLCs and how they differ from ownership interests typically associated with stock options (<https://www.legalzoom.com/business/business-formation/llc-overview.html>)
4. Cooley LLP dives into the legal and tax complexities of profits interests for LLC members, including comparisons to equity compensation (<https://www.wtwco.com/en-us/insights/2023/09/profits-interests-are-they-the-right-iti-design-for-your-llc-firm>)
5. This Law.com article discusses how profits interests in LLCs are taxed for US residents, providing a clear contrast to stock options with their capital gains tax treatment (<https://www.hutchlaw.com/blog/what-is-a-profits-interest>)

# TOPIC THREE – DELAWARE NO MORE (TAX-WISE)

Delaware is universally considered the go-to destination for establishing a US C-corp. The reasons are well-documented – robust case-law, no state income tax, anonymity of director and officers. Now however the holy grail status of Delaware has been challenged.

To many founders the recent judgement of the Delaware Chancery Court that invalidates Elon Musk's pay package is a sign that Delaware has too long a reach into a corporation's internal affairs in favor of protecting the rights of minority stockholders. Aside from Tesla, other prominent public companies that have recently or in the process of leaving Delaware for Nevada include TripAdvisor, X (formerly Twitter) and TransPerfect. The stated reasons for leaving Delaware are absence of clarity on Chancery Court decisions and a perceived Court bias in preserving minority stockholder rights. Ironically the large majority of companies have the opposite view, which is that the extensive body of Delaware caselaw establishing and defining the business judgement rule protects the decisions and actions of officers and directors when taken prudently.

Nonetheless, the iron grip that Delaware has had as the preferred US jurisdiction in which to domicile corporations is now being questioned and is open to re-examination. Another factor contributing to this reexamination of where to domicile a company is the impact of the Pandemic and the physical relocation of companies and staff to lesser-cost, lower tax and more business friendly states such as Texas, Nevada and Florida. Up to now institutional investors startups to incorporate in Delaware as a condition to funding, mainly as a risk-mitigation measure to protect investor-directors. Whether this condition continues is unknown. Perception of whether a state is business friendly is subjective in many respects, but what can be objectively compared are the corporate tax rates or formulations among the states. On that measure Delaware tax must be considered. Here's how the major low corporate tax states line up:

Delaware Franchise Tax: Delaware allows corporations to calculate franchise tax in two ways.

The Authorized Shares Method uses the number of authorized shares to determine the franchise tax due. Corporations with 5,000 or less authorized shares pay a franchise tax of \$175 plus (i) an additional \$85 for the first 5,000 shares in excess of the initial 5,000 (i.e., 5,001 – 10,000 shares) and (ii) another \$85 for each 10,000 shares. The maximum tax under this method is \$200,000. The capital base of many startups consists of between 10M-15M authorized shares at the time of formation in order to keep the per share price low and allow for the optics of granting a large amount of shares as incentive equity compensation to new hires. This capital base increases with each new round of financing as companies grow. If the Authorized Shares Method is applied, Del tax could be substantial.

The Assumed Par Value Method is an alternative. Under this method (i) the gross assets of a company are divided by the number of outstanding shares, (ii) multiplied by the number of authorized shares, (iii) rounded up to the next \$1M of gross assets, and (iv) applied to a franchise tax rate of \$400 per \$1M. The key variables under this method are a company's gross asset value and the authorized but unissued shares. Startups with a low gross asset value less than \$500K will typically pay the franchise tax of \$400. However for companies with a gross asset value above \$5M the franchise tax may be in the range of \$2K per year. Tax on more mature companies may range between \$5K-\$10K per year.

## Alternatives.

The following states have lower corporate tax and also apply the business judgement rule to protect officers and directors:

1. Texas applies a gross receipts tax. As of January 1, 2024, businesses (i) with less than \$2.47M in annual gross receipts pay no state tax and (ii) those with gross receipts ranging from \$2.47M up to \$20M pay 0.331% of the gross receipts. For businesses with gross receipts in excess of \$20M, the tax rate on ranges from 0.375% for retail and wholesale businesses to 0.75% for others.

2. Wyoming has no business taxes. There is no income tax, no franchise tax or any other form of business levies in the State. Wyoming is notable for enacting friendly and flexible laws and regulations for companies in the cryptocurrency sector but does not have extensive caselaw on fiduciary matters.

3. Nevada has no income tax and no franchise tax. But like Texas imposes a gross receipts tax on companies with gross annual revenue exceeding \$4M. The tax rate is low ranging between 0.05% to 0.3% depending on the sector of the business.

4. Florida has a corporate income tax rate. Of 4.445% applied to adjusted federal taxable income. However, for businesses operating entirely outside of Florida, the state does not levy corporate income tax on their earnings, though filing obligations remain. This makes Florida a potentially attractive option for businesses considering incorporation locations, particularly for those with operations primarily beyond the state's borders.

## Topic References:

1. While this Reuters article details a recent Delaware lawsuit against Tesla, it also highlights potential drawbacks of the Delaware Chancery Court for some businesses (<https://www.linkedin.com/pulse/delaware-judge-invalidates-elon-musks-56-billion-tesla-pay-32zsc>)
2. This is the official Delaware Division of Corporations website with detailed information on Delaware's franchise tax structure, a key factor driving companies to consider alternative states (<https://support.stripe.com/questions/how-to-pay-delaware-franchise-tax-online>)
3. Texas Secretary of State's website provides information on incorporating a business in Texas, showcasing its business-friendly tax laws compared to Delaware (<https://direct.sos.state.tx.us/help/help-corp.asp?pg=fee>)
4. Florida Department of State's website highlights the advantages of incorporating in Florida, including potential tax benefits compared to Delaware (<https://incparadise.net/florida/advantages-incorporating-business-florida/>)
5. Nevada Secretary of State's website offers information on incorporating a business in Nevada, another state known for its tax-friendly environment for businesses (<https://www.nvsos.gov/sos/businesses/start-a-business/limited-liability-company>)

# TOPIC FOUR – TARIFF WORKAROUNDS REGARDLESS OF WHO WINS THE ELECTIONS

The Tariff Wars are tearing up the world and it seems everyone is in on the act: US v. China / China v. US; US v. Europe / Europe v. US...and to a lesser extent other global regions. With the looming US presidential elections in Fall 2024, as far as tariffs go its likely not going to make a difference whether Biden or Trump is elected – both have circled China as a leading trade competitor deserving of a fresh look at new targeted tariffs. Notably, geopolitical competition between the major global trading blocks now see tariffs as the weapon of choice to even the economic playing field. This is a huge issue for global manufacturers of tangible goods adding from 25% to 100% to the cost of imported products. Corporate planning is further complicated by tariff rules that continually change with each new administration and global crisis.

The choices available to manufacturers mostly have been to reset supply chains and strategically locate manufacturing facilities in key markets where customers are located. But as tariffs change, if manufacturing facilities are in markets targeted by unanticipated new tariffs then the problem is worse not better.

The solution might be to establish a more flexible supply chain feeding into final assembly operations located in key regional markets close to the largest groups of customers in those regions. For consumer and industrial tangible product companies a commercial solution that seems to work is (i) the fabrication of inexpensive component parts in a central hub (a “Central Hub”) which (ii) are then shipped to regional fulfillment houses (“Regional Fulfillment Centers”) that assemble component parts into complete products sold to customers within the same regions/markets where the Fulfillment Centers are located. The idea is (i) to assure manufacturing consistency through the Central Hub, (ii) reduce tariffs by shipping cheap disassembled component parts to Regional Fulfillment Houses in markets where customers are located and (iii) Regional Fulfillment Houses assembling and shipping to end-use customers. To cover primary markets Fulfillment Houses might be identified in each of US, EU and Asia. Clearly Fulfillment Houses must be selected based on quality and ability to scale. This supply chain and regional assembly approach either works or not based on the product, markets and supply chain required. If it does then the commercial agreements between the production entities involved need to address the following:

- Pricing – Component parts must be designed to have little independent value, ideally with all components fabricated by a single Central Hub for scaling and quality control.
- Assembly & Fulfillment Flexibility – Necessary to accommodate scaling to regional market growth
- Dedicated Resources – Consider dedicated teams and options to direct hire

## Topic References:

1. “Trade Wars: Strategies for Mitigating Tariff Risks” – This PwC report directly aligns with the article’s discussion of supply chain adjustments to navigate tariffs. It provides strategies companies can use to restructure operations and supply chains to mitigate tariff impacts. (<https://www.pwc.com/gx/en/issues/assets/trade-war-strategy-paper.pdf>)
2. “How companies are trying to survive the tariff fight between the U.S. and China” – This CNBC article gives real-world examples of companies shifting manufacturing out of China and using tactics like regional fulfillment centers, which supports the approach outlined in the article. (<https://www.cnbc.com/2019/08/29/how-companies-are-trying-to-survive-the-tariff-fight.html>)
3. “Supply Chain Restructuring as a Response to Trade Tensions” – This Baker McKenzie client alert provides legal and operational guidance for companies looking to restructure supply chains, very relevant to the regional fulfillment center model described. (<https://www.bakermckenzie.com/en/insight/publications/2019/03/supply-chain-restructuring-as-response>)
4. “Managing Supply Chain Risk in the Era of Protectionism” – This Harvard Business Review article discusses the challenges tariffs pose and need for supply chain resilience, backing up the rationale for the regional assembly approach. (<https://hbr.org/2020/07/managing-supply-chain-risk-in-the-era-of-protectionism>).
5. “Beating the Tariff Increase with Supply Chain Restructuring” – This Supply Chain Brain article directly reinforces the core strategy of realigning supply chains and manufacturing footprints mentioned in the article. (<https://www.supplychainbrain.com/articles/30057-beating-the-tariff-increase-with-supply-chain-restructuring>)

# TOPIC FIVE – TAIWAN – BUSINESS LESSONS FROM UKRAINE

In an era fraught with geopolitical uncertainties, Taiwanese tech companies face the imperative of fortifying their operations against potential disruptions. Drawing insights from global events, particularly the ongoing crisis in Ukraine, Taiwanese firms can proactively mitigate risks and ensure business continuity.

Diversifying Supply Chains: Creating redundant supply chains outside Taiwan emerges as a cornerstone strategy for mitigating risks associated with potential disruptions. Taiwanese tech companies must strategically establish manufacturing facilities, sourcing partners, and distribution networks in regions such as the US, EU, greater Asia, and Latin America. This diversification ensures continuity of operations even in the face of geopolitical shocks.

Tangible vs. Intangible Businesses: It's essential to discern the differences between tangible and intangible businesses in their diversification efforts. While tangible businesses focus on physical infrastructure and logistics, intangible businesses should prioritize digital infrastructure and cybersecurity to safeguard against cyber threats and data breaches.

Adapting Business Models: In light of geopolitical uncertainties, Taiwanese tech companies may need to adapt their business models to navigate changing market dynamics. This could involve shifting from a centralized manufacturing approach to a more decentralized model, where production facilities are strategically located across multiple regions. Additionally, embracing digital transformation and investing in remote work infrastructure can enable companies to maintain operational continuity during times of crisis.

Government Support and Collaboration: Companies can benefit from government support and collaboration initiatives aimed at enhancing resilience and mitigating geopolitical risks. Government agencies can provide resources, guidance, and incentives to support companies in diversifying their operations and establishing strategic partnerships. Collaborating with industry associations and other stakeholders can also facilitate knowledge sharing and collective action to address common challenges.

#### Navigating Regulatory Challenges:

Expanding operations into international markets requires companies to navigate complex regulatory landscapes. Each region may have its own set of regulations governing trade, investment, intellectual property rights, and data privacy. Companies must conduct thorough due diligence and ensure compliance with relevant laws and regulations to avoid potential legal and regulatory hurdles that could disrupt their operations.

Scenario Planning and Contingency Plans: In addition to proactive measures, Taiwanese tech companies should develop scenario plans and contingency strategies to respond effectively to potential disruptions. This involves conducting risk assessments, identifying potential threats, and outlining response protocols to mitigate the impact of geopolitical events on business operations. scenarios, companies can enhance their agility and resilience in the face of uncertainty.

Key Terms in Strategic Partnering Agreements: In implementing any of the points above its important to consider the following terms in partnering agreements:

- Options to scale supply and business volume
- Variable discount pricing with increase volume
- Dedicated production resources with options to divest into controlled business entities
- Favorable tariff and logistics expenses
- Partner cooperation on visas, direct customer support, joint venture structures

#### Topic References:

1. "Strategic Partnerships Amid Rising Geopolitical Risks" This S&P Global report examines how companies across sectors are leveraging strategic partnerships and joint ventures to navigate geopolitical turbulence, echoing the recommendations in the article for Taiwanese tech firms. (<https://www.spglobal.com/ratings/en/research/articles/230222-strategic-partnerships-amid-rising-geopolitical-risks-12357507>).
2. "How Companies Can Mitigate Geopolitical Risks". A McKinsey article providing a framework for companies to assess and respond to geopolitical risks through measures like supply chain diversification, scenario planning, and regulatory adaptation - tactics highlighted throughout the article. (<https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/how-companies-can-mitigate-geopolitical-risks>)
3. "Building Resilience Amid the New Geoeconomic & Geopolitical Global Landscape". This Deloitte report discusses strategies businesses can adopt to enhance resilience against intensifying geopolitical and geoeconomic tensions, including multi-sourcing, cybersecurity investments, talent strategies - all highly relevant points raised in the article. (<https://www2.deloitte.com/xe/en/insights/focus/gx-resilience-amid-new-geoeconomic-geopolitical-global-landscape.html>)