Founders, Helpers, and Angels:
Dividing the Company Pie

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Attorneys from McGuireWoods, as well as Cooley, DLA Piper, Troutman Sanders, Williams Mullen and others recently participated in the 43rd Annual Advanced Business Law Conference sponsored by the Virginia State Bar Business Law Section and Virginia CLE. We titled the conference "*Back to the Future — Business Lawyering For all Stages of the Company Life Cycle.*"[1]

Our message was that startup and emerging growth companies have to plan with their dynamic and unpredictable futures in mind. The conference featured the life of a promising technology company serving the food industry. Our presenters included big and small law firm practitioners and in-house counsel who shared their experiences in advising rapidly-growing companies from startup, through growth and expansion, and ultimately to a successful sale. We looked at the emerging company's life cycle from the business lawyer's "liberal arts" perspective, including tax, intellectual property, employment, securities, technology licensing, other third party arrangements and strategic alliances, international expansion and mergers and acquisitions.[2] Below, we borrow from some of the conference presentations, other sources, and our own experiences to address one significant area in advising startup and growth companies — structuring a company's equity ownership among its founders, employees (and perhaps consultants and directors), and the "angel" investors who are kind enough to make an early bet on all of them. This is intended as a general overview of the business and legal issues that should be addressed when assisting emerging companies with formation, employee and angel investor equity issuances, and the governing documents. A more thorough discussion of each of the many evolving securities, tax, and other legal issues surrounding company equity planning and design is beyond our intended scope, and can be obtained by viewing the conference video online. We offer this as a practical, business lawyer's perspective on the design of a company equity capital structure for both legal protection and future transaction flexibility.

Company Ownership: Seems Important, and It Will Change

Our context is equity ownership planning for startup and "emerging growth" companies — that is, those early-stage, often technology-enabled companies that are, due to their dependence on human talent and innovation and relatively low capital requirements, attractive targets for "venture capital" investors but that have not yet raised their first "Series A round."[3] These companies have either recently started or are still transitioning from product research and development to market acceptance, revenue, and profitability. They rely heavily on their technology or service advantage and smart people more than buildings, machines, and banks. They are initially managed by their founders, and they typically offer equity ownership (in the form of stock or stock option grants) to their key employees and consultants both to supplement initially below-market compensation rates and to align the interests of the founders and key personnel. These companies require capital investment from early-stage or "seed" investors (for completion of product development, customer retention and new hires), including friends and family of the founders, and wealthy angel investors and family officers who have a particular interest in or passion for the company's business. As such, emerging companies often realize no profit and even have no revenue for several years while they develop their products and services and build their management team, but they promise relatively low capital requirements (or "burn rates") and rapid market traction. The ultimate ownership percentages of the founders, employees, and angel investors are difficult to project, as they will be impacted by the company's progress, setbacks, and capital needs (including the number of size of future equity financings) prior to a liquidity event or sale.

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Who owns what interests in a company is critical to all current stakeholders and will be equally important to future investors and potential buyers. The founders want to maximize the amount they will receive in a future sale. They also want to ensure that key employees have the incentive to remain with the company and that they will not receive an unearned "windfall" if they choose to leave early or are terminated for cause. Then, there are the outsiders — the angel investors — including friends and relatives of the founders, or perhaps wealthy executives or family groups with a particular interest in the company's industry who place risky bets on the founders and their vision. The founders want to treat these early mentor investors fairly, but need to carefully consider what to offer them for their seed capital, as their equity will not only dilute the founders' and employees' company interests but their terms could impact the terms demanded by future investors. Later Series A investors frequently have strong ideas about how company ownership should be allocated among management prior to their investing, as they usually have a different perspective on the relative contributions that should be rewarded and the incentives they want to provide. As examples, fund investors often request that ownership among key management personnel be realigned to more fairly reflect past and expected contributions, and that early investors agree to waive certain rights that they view as excessive or off market.

The business lawyer representing the emerging company must become familiar with the "capitalization table" of the company[4] and recommend and prepare legal documents that define the rights and obligations of the equity holders of the company.[5] These legal documents are critical to future planning, risk management, successful capital raising, and a profitable exit. The "cap table" and legal documents should obviously be accurate and consistent (although the corporate minute books and stock ledgers of many early-stage companies are often deficient or non-existent), and should anticipate future events such as employee terminations, option exercises or note conversions, capital raises, and company sales. For planning purposes, the cap table should also present the fully-diluted ownership of the company to provide a picture of the pro forma ownership of the company as if all reserved options were granted and exercised and all outstanding options, warrants, and convertible notes were converted into equity.

Corporations and LLCs

Most startup and growth-stage companies are either regular "C" corporations or limited

liability companies (LLCs) treated as partnerships for income tax purposes.[6] While many advisers recommend that emerging companies planning to raise venture capital organize as or convert to a corporation, in practice a large number of successful emerging companies continue to operate as LLCs, even through ultimate sale. Most of the planning tips discussed in this article apply to equity ownership in either a corporation or an LLC, although the legal documents will differ in form and there are some tax distinctions that will be discussed.[7] Unless the context requires otherwise, references to "company" are intended to include a corporation or an LLC, references to "equity," "ownership," "stock," or "shares" are intended to refer to either the capital stock of a corporation or the membership interests of an LLC.

The Emerging Company Stakeholders — So Many Fingers in the Pie

During the startup and early growth phases of a company's existence and prior to the company's first "Series A" round,[8] there will usually be three different categories of equity owners: the founders, key employees and consultants, and early angel investors. One or more founders may have formed the company, agreeing to contribute services or intangible assets such as a business plan, know-how and other intellectual property, and agreed on some sharing of common shares or loans to the company.[9] The company may have promised or granted common shares or stock options to one or more key employees or independent contractors as additional incentive compensation and "golden handcuffs" for staying with the company through the critical phases from startup, to development and commercialization.[10] And one or more angel investors may be considering an investment in the company or may have already advanced funds, either in the form of a loan or purchase of shares.[11]

Founder Equity — Past Contributions and Future Commitment

The founders usually form the company and agree on their respective percentages of the common equity of the company. In the authors' experience, they often agree on arbitrary splits that may not reflect the relative contributions being made by each (whether sweat equity, personal expenses, or intellectual property), and over time they may regret their original deal. Here are some of the most common mistakes relating to the issuance of founder stock[12]:

Not Imposing Founder Vesting Terms. Issuing founder shares without vesting restrictions or documentation reflecting the founder's contribution of cash, intellectual property or services is common but often ill-advised.[13] While it may seem odd for founders to self-impose vesting restrictions, it can provide important incentives and protections among them and also make angel investors more comfortable to invest (as they are investing in people, not just the business concept).

Forgetting that Stock May Be Taxable Compensation. Failing to issue founder shares as early as possible (e.g., to avoid proximity to a priced equity round) or consider and file a timely "83(b)" election with the Internal Revenue Service (e.g., if the shares are subject to vesting restrictions) can create issues not only for the founders but due diligence concerns from investors.

Arbitrarily Assigning Equal Shares to Co-Founders. Assuming that an equal or close-to-equal equity sharing among multiple founders is or will always be fair often creates ill will and can lead to future disputes.

Not Having a "Prenuptial" Agreement. Failing to have the founders bound by an appropriate buy-sell or stockholder agreement that provides appropriate rights and restrictions regarding transfers of their stock creates unnecessary legal risks. Such agreements, when coupled with vesting restrictions on founder equity, essentially serve as a prenuptial agreement among the founders and future stockholders, addressing "what ifs" such as the disposition of shares upon termination or death.

Key Employee (and Consultant) Equity — Tax Efficient "Golden Handcuffs"

Almost all emerging companies eventually decide to award key employees (and consultants, directors, and independent contractors) equity incentives. These can take a variety of forms, but most often are structured as restricted stock grants or stock options. The following is a list of planning opportunities and pitfalls:

Tax Implications — Uncle Sam May Want a Slice. In designing employee equity incentives, the focus is often on the tax implications to the employee, but their tax treatment can drive the timing of any corresponding tax deduction as well. The receipt of stock in

connection with the performance of services results in compensation income equal to the excess of the fair market value of the stock over any purchase price paid for the stock (whether in cash or pursuant to a recourse note). However, if the stock is subject to vesting — unless an 83(b) election is made within thirty days of receipt of the stock — income is recognized as the vesting restrictions lapse and is based on the value of the stock on the future lapse dates. As a result, an 83(b) election permits the employee to recognize less ordinary income upon receipt and make the future appreciation in value of the stock eligible for capital gain treatment.

Options Should Be at Fair Value Exercise Price (or Not Exercisable When Vested). Although stock options delay actual equity ownership and require the employee to pay for the stock, some founders prefer them precisely for those reasons. They prefer putting off the day when employees obtain stockholder rights and often want them to have skin in the game. The grant of a stock option with an exercise price equal to the fair market value of the optioned stock is not generally taxable, while the exercise of the option will result in compensation income equal to the difference between the fair market value of the optioned shares at the time of exercise and the exercise or strike price.[14] Perhaps the biggest pitfall and planning tip with respect to stock options is setting the exercise price below the failure market value of the stock. Unless the stock option is designed to defer exercise until the earlier of termination of employment or a company sale, granting bargain stock options will trigger immediate income tax and penalties under Section 409A of the Internal Revenue Code.[15] And amending or changing outstanding options can also trigger 409A problems.

LLC "Profits Interests" — Our Favorite. Although beyond the scope of this article, LLCs permit the use of a tax-favorable employee equity incentive known as a profits interest. Although, for state law purposes, a profits interest is typically documented as and constitutes actual equity (like corporate stock), the tax laws governing the issuance of vested and unvested LLC (or partnership) interests for services allow for non-recognition treatment provided that the LLC's operating agreement and tax records satisfy certain requirements.[16]

Securities Law Compliance. In addition to the tax laws, emerging companies must comply with the securities laws when granting equity incentives to employees. Even if a company avoids scrutiny by the SEC and state agencies, future investors or buyers are always concerned about a target company's compliance with the securities laws. Fortunately, Rule 701 of Regulation D exempts equity incentive grants under a compensatory plan even though the recipients are not accredited investors for purposes of the Rule 506 safe harbor exemption, which is most commonly relied upon by emerging companies. However, the amount of securities issued sold under Rule 701 (including those issued in the prior twelve months) may not exceed the greater of $1 million or 15 percent of the company's total assets or outstanding securities of the class being issued. It is advisable to either adopt an equity incentive plan or clearly reflect in the underlying restricted stock award agreements or stock option agreements that the stock or options are being granted as part of a compensatory plan.

Vesting and Transfer Terms. Many emerging company restricted stock award or stock option agreements are poorly drafted or fail to anticipate certain scenarios. The business lawyer should always ask the following questions:

- Does vesting accelerate upon a sale of the company in full or only partially, or should there be a double-trigger vesting term that incentivizes the employee to remain with the company for at least a short transition period after the sale?[17]
- Is the agreement clear as to when the right to exercise an option following termination of employment expires?
- Does the agreement permit the company to repurchase the stock upon termination of employment either at fair market value for vested shares or cost or zero for unvested shares or in the case of termination for cause?
- Does the agreement clearly obligate the employee with respect to withholding and income taxes relating to the grant or exercise of the option?

We have encountered countless situations where the failure to at least consider these questions resulted in disappointed company executives years after they granted stock or options.

Angel Investor Equity — Convertible Debt, "SAFE" or "Series Seed" Preferred Stock

Two trends have dramatically changed the venture capital markets over that last five to ten years. First, a much broader and diverse collection of investors are providing seed or very early-stage capital to startup and emerging companies. They include wealthy individuals and family groups, serial entrepreneurs who have themselves made money building and selling companies, corporate strategic investors, and even some larger institutional funds who more typically invest in later-stage companies. Second, rather than moving rapidly from a founder common equity structure, perhaps selling some convertible notes or common stock to friends and family investors along the way, to a Series A preferred stock round, more companies have been able to delay their Series A or institutional investor round by raising larger amounts of incremental equity through convertible notes, so-called series seed preferred or simple agreements for future equity (SAFEs). This phenomenon has resulted in the term "super seed rounds."

1. *Convertible Notes.* Because an emerging company is typically completing the development of its products or services and has not yet achieved market acceptance or even generated revenue, it is difficult for the founders and angel investors to agree on an appropriate valuation of the company. If the angel investors were purchasing equity or stock, such a valuation would be necessary to determine the percentage of the company's shares that would be issued to the investors. Valuation of an emerging company is often arbitrary and is certainly subjective and uncertain. Therefore, many founders and angel investors agree to have the investors purchase convertible notes – that is, debt securities instead of equity securities. The notes accrue interest on the principal or investment amount and are usually payable in a lump sum in three to five years. However, the typical plan is for the company to raise equity capital at some point before the notes become due and payable, thereby providing a reference point for the company's value. A typical convertible note might provide that, in the event of an equity financing of some meaningful or minimum amount (e.g., $2 million), the note would convert into the same class and series of shares of stock that are sold in that financing to other investors. To compensate the investor for its risk, most often the note would convert based on a discounted price (e.g., 80 percent of the price paid by investors in the future equity financing). It is also increasingly common for the conversion price to be capped. Thus, for example, the note would convert into the greatest number of shares determined based on the discounted price or a maximum or capped pre-money valuation of the company. In this way, the note investor is protected from significant dilution as a result of an excessively high company valuation in the equity financing. A typical note would also provide for some premium payment or conversion option in the event of a sale of the company prior to the note's maturity or an equity financing. Convertible notes are relatively common for the first $1 million raised by an emerging company because they avoid the valuation issue and are simpler to document than a stock sale.

2. *SAFE.* This form of security — the simple agreement for future equity — was developed in 2013 by Carolyn Levy, an attorney at Silicon Valley accelerator Y Combinator. A SAFE is more similar to a stock warrant than convertible debt or stock itself. The investor pays for the right to receive equity if and when the company raises capital in the future or is sold. Therefore, a SAFE is really not equity like stock or debt possessing the right to be repaid on some future maturity date. If the company fails, the investor receives nothing and has no legal claim against the company's assets. Like a convertible note, however, a SAFE allows the founders and investors to put off valuing the company until a future equity financing that sets such a value. SAFEs have been popular with emerging companies and investors who wish to avoid negotiating somewhat more complex convertible note forms.[18] However, they are certainly a better deal for the company than an investor in search of future leverage and bargaining power.

3. *Seed Preferred.* Seed preferred stock (referred to by different labels such as Series AA, Series A-1, and Series Seed preferred stock) has become the market norm for a first-priced, equity round typically involving angels and family offices and, at times, even a first round with a venture fund or corporate strategic investor. It is often used to raise from $1 million to $3 million. As compared to standard Series A preferred stock, the terms of seed preferred are less onerous for the company and its founders and, increasingly,

the terms are very standardized due to the availability of different published forms of term sheets, purchase agreements, and series seed documents.[19]

Unlike the more robust Series A preferred stock sold to venture capital funds and other investors later in a company's first institutional equity financing round,[20] series seed preferred typically carries a liquidation preference and is convertible into common stock, but is not of the double-dip or participating variety of preferred stock that entitles the holder to both a priority return of investment and participation in profits thereafter on an as-if-converted basis. Series seed preferred will more frequently not have a preferred dividend or coupon (e.g., 8 percent), but will only be entitled to participate on a *pari passu* basis with the common stock in dividends. Series seed investors will also usually have significantly fewer consent or approval rights, perhaps limited to the right to veto changes in the company's capital stock, changes in its authorized preferred equity or, less frequently, major transactions such as a merger or sale of the company. However, similar to Series A preferred stock, the holders of series seed preferred will typically have preemptive rights to purchase their pro rata share of future equity offerings and insist that any employee equity or option reserve only dilute the founders. Depending on the company's status and negotiating leverage and the value that a particular investor may be able to provide the company as a mentor investor, the series seed may or may not be entitled to elect one or more members of the company's board of directors.

Counsel to an emerging company is part legal and part business adviser.

The Business Lawyer's Role and Value in Designing the Company's Capital Structure

Counsel to an emerging company is part legal and part business adviser. As a gatekeeper tasked with advising the emerging company, the business lawyer must be mindful of whom he or she represents, as the interests of the founders, key employees, and angel investors in their "piece of the action" will be different and eventually adverse. The business lawyer will need to engage the help of securities and tax specialists who are up to speed on the latest changes in the law, as well as perhaps colleagues who more routinely handle venture capital transactions and are attuned to the most recent market terms and trends. Assisting the company with the design of its initial and growth-stage equity ownership requires attention to detail, consideration of the different contributions being made by each stakeholder, thoughtful drafting to ensure continuity of ownership and fair vesting and buyback rights and obligations in the event of changes in personnel and, perhaps most important and challenging, a "crystal ball" of the future. Of course, no such crystal ball exists. Therefore, counsel and the client should carefully review and attempt to project the company's future progress and need for capital. The cap table and legal documents surrounding the company's common stock, employee equity grants, and any convertible notes, SAFEs or series seed preferred stock, will be closely scrutinized by prospective investors or buyers of the company. As a result, they should be designed and prepared with flexibility and appropriate leeway and outs to address unforeseen circumstances or investor demands. Getting company ownership right and ensuring that the capital structure will allow the company to grow is much easier if the issues discussed in this article are considered at the outset, optionality is reserved, and ownership is periodically revisited as the company moves from startup through growth and successive financings.

The effective business lawyer is able to advise a company's officers and board of directors with the company's best interests in mind. If the founders are not satisfied, the company will suffer. If key employees are not incentivized, the company will suffer. If angel investors are not provided with terms that convince them to contribute much needed capital to the company, it will suffer. When considering vesting and other restrictions, each founder and employee should consider that his or her equity will be better protected and more likely to appreciate in value if the entire team is subject to reasonable terms and obligations. While there is seldom a win-win-win in business, the most successfully companies methodically plan their equity issuances with the long-term in mind, thereby allowing all stakeholders to earn a fair return on their shares.

As counsel to the company, the business lawyer needs to see the company not only

through the eyes of its founders but also its key managers and future investors. Each new block of stock that is added to the capital structure will have implications for current stockholders and future transactions. As contrasted with later Series A and subsequent financing rounds where the investor's counsel often controls the document drafting, the business lawyer to an emerging company can play a critical and primary role in preparing the initial term sheet for discussion with the lead angel investor. The company should have more leverage to manage the angel investment process if it proposes fair and market terms to prospective investors.

It is absolutely the case that investors focus as much on the jockey (the company's management) as the horse (the company's products and services). With this in mind, founders should be encouraged to cross all of their equity capital Ts as soon as possible. Although emerging companies must be sensitive to legal fees, getting tax, securities, and corporate law compliance right from the beginning will be much less expensive and add much more value in the long run.

Adherence to best emerging company practices will ultimately enhance the company's prospects for success and its exit value. For example, attention to Rule 506 and Rule 701 will allow the company to raise money without the need to develop a lengthy private placement memorandum nor to comply with often conflicting state blue sky securities law requirements in states where investors may reside. Good legal forms tailored to the specific situation and early tax planning will avoid unhappy employees and expensive fixes, and protracted investor and buyer due diligence, and even litigation, down the road. Encouraging all stockholders, the founders, key people, and early angel investors alike, to accept balanced documents with market terms addressing their respective rights and obligations as owners will not only minimize the risk of future disputes but also impress future investors and buyers that the company's house is in order.

Here's to those of our Business Law Section of the Virginia State Bar that have the stomach not to specialize. You are as entrepreneurial as the growing number of emerging companies looking for practical and business-oriented legal advice. And, by not merely advising young companies on risk mitigation, but counseling them on ownership and financing structures that will actually enhance their value and prospects for successful growth, you are providing a great service to clients striving to become game changes in our economy. See you next year at the 44th Annual Advanced Business Law Conference.

Endnotes:

1 Virginia CLE and Virginia Law Foundation.

2 The authors are grateful to Virginia CLE and the following presenters at the conference and their law firms for permitting the use of their conference outlines in preparing this article: Julia T. Kovacs, DLA Piper, Washington, DC, Michael R. Lincoln, Cooley LLP, Reston, Virginia, and Cathryn Le Regulski, DLA Piper, Reston, Virginia.

3 The first round of equity financing in the form of preferred stock from an institutional investor such as a venture capital fund is often referred to as a "Series A" round because the class of preferred stock typically issued is designated as "Series A" preferred stock and is often followed by successive "B," "C", etc., financing rounds.

4 Often referred to as a "cap table," this refers to a spreadsheet or schedule that lists the stockholders or members of the company and the number and class of shares, options or other securities owned by them.

5 If the company is a corporation, the respective rights of the stockholders are usually set forth in the articles or certificate of incorporation, bylaws, and one or more "stockholder" or "stock restriction" agreements among the company and one or more stockholders. If the company is an LLC, these rights are usually incorporated into the company's operating agreement and perhaps separate agreements memorializing employee equity grants or angel equity purchases.

6 Subchapter "S" corporations cannot have different or "preferred" classes of stock or non-individual shareholders, making it more difficult to structure angel investments in the company.

7 Perhaps the biggest distinctions as between an LLC and corporation are the availability of "profits interests" as an alternative form of employee equity compensation for LLCs and the need to coordinate income tax allocations in LLC operating agreements with the intended economics sought to be achieved by the capital structure. See Steven J. Keeler, Operating Agreements for "Emerging Growth" LLCs: A Deal Lawyer's Perspective on Tax Provisions, The Virginia Lawyer, October 2009, Vol. 58, page 36.

8 This typically refers to the first equity financing of a company with a venture capital "fund" or other "institutional" investor and which usually involves more complicated terms than the earlier "seed" preferred rounds discussed later in this article. A Series A round typically occurs after a company has previously raised $5 million or more from "friends and family", "angel" or "family office" investors.

9 There are seldom material tax issues associated with the founders' initial equity, as property

contributions for equity are generally tax-deferred under IRC Section 315 (corporations) and IRC Section 721 (LLCs). If equity is being acquired for services, compensation income can usually be minimized or avoided if the founders' equity is issued well before the company's first capital raise or the common equity value can be minimized due to any convertible debt or preferred stock sold to investors.

10 This is an area where many emerging company's records are inadequate, thereby creating legal and morale issues as to what was promised to which service providers and often causing otherwise avoidable tax issues.

11 Similarly, early stage companies often neglect to ensure that investor agreements and documents are clear and consistent.

12 Some of these were taken from "Working Knowledge, Harvard Business School, Top Ten Mistakes Made by Entrepreneurs, by Constance Bagley.

13 Many startups make the mistake of accruing salary compensation for the founders and others until the company can pay the compensation. This can have unintended tax (e.g., Internal Revenue Code Section 409A) and other legal consequences. Equally common, many startups incorrectly classify early-stage personnel as independent contractors when they are in fact employees (different but similar tests are applied by the IRS, the NLRB and DOL).

14 This assumes the stock options are the more common "non-qualified" stock options and not "incentive stock options."

15 The potential application of IRC Section 409A to a wide variety of employee compensation arrangements and other agreements cannot be overstated. 409A applies to any employee, director or independent contractor — not just executives — of a private or public company. Inadvertent violation results in serve tax penalty to the individual (immediate income inclusion and addition 20 percent income tax upon vesting) and reporting and withholding obligations for the company.

16 Rev. Proc. 93-27, 1993-2 CB 342; Rev. Proc. 2001-43, 2001-2 CB 191; Notice 2005-43, 2005-24 I.R.B. 1221.

17 "Single-trigger" vesting results in full or partial vesting of unvested shares upon certain events such as a company sale or termination without cause. "Double-trigger" vesting requires to vesting events — a sale of the company followed by a termination (by the buyer) without cause within typically nine to eighteen months. Because most emerging companies actively plan for a sale, their investors prefer double-trigger vesting because prospective buyers will want adequate incentives in place to retain company management through a post-sale transition or integration period.

18 See Venture Capital Coast to Coast, June 2015, McGuireWoods LLP. See also Startups Off Unusual Reward for Investing, The Wall Street Journal, April 2, 2015, at B7.

19 See, e.g., forms published by Y Combinator at www.ycombinator.com/documents/; by Techstars at http://www.techstars.com/docs/; and www.seriesseed.com.

20 The National Venture Capital Association publishes a full set of Series A preferred stock purchase documents which are routinely used. However, business lawyers should be aware that they are extremely investor-favorable. http://nvca.org/resources/model-legal-documents.

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Tax Incentives *continued from page 24*

Endnotes:

1 Va. Code § 58.1-409.9

2 While an experienced IC-DISC legal and tax accounting team may make this complex program relatively easy for clients to implement and administer, it is a complex program subject to many initial and ongoing conditions and qualifications that are beyond the space constraints and purposes of this article.

3 2015 U.S. Trade Policy Agenda.

4 The IRC imposes specific organizational qualifications that must be met for IC-DISC eligibility, including that it be formed as a domestic corporation having only one class of stock, the par or stated value of its outstanding stock must be at least $2,500 on each day of the taxable year, and that an election designating it as an IC-DISC be in effect for the tax year in issue. IRC § 992(a)(1).

5 IRC § 991.

6 IRC § 993(c).

7 The "United States" for purposes of the IC-DISC program includes Puerto Rico and the possessions of the US IRC § 991(g).

8 Excluded products include, among others, unprocessed timber that is softwood and products such as coal with respect to which a deduction for depletion is allowed. IRC § 993(c)(2).

9 Among other requirements, the services must be "subsidiary" to the sale or lease of QEP, based on projected value of such services in relation to the QEP sold or leased, and the originating contract must include or make a qualifying offer of such services (which may include via implied warranty).

10 IRC § 994.

11 IC-DISC eligibility requires that the corporation meet two main tests under IRC § 992(a)(1): (a) at least 95 percent of its gross receipts must the qualified export receipts, and (b) at least 95 percent of the adjusted basis of all of its assets at the end of its tax year must represent qualified export assets.

12 See IRC § 993(d) and 995(b)1((E)

13 IRC § 995(f). For the 2015 tax year, the applicable rate was only .24 percent.