Co-Founder Equity

Splitting ownership is easy on day one. The terms that matter are the ones that decide what happens on day four hundred.

Two or three people start a company. Someone suggests an even split, everyone agrees, and the conversation moves on to the product. Nobody asks what happens if one founder leaves in month eight, stops working in year two, or was never going to put in the hours the others did.

Those questions get answered either way. The only choice is whether you answer them now, while everyone gets along, or a court and your state's default rules answer them later.

Equity Should Be Earned, Not Just Granted

An outright grant of equity on day one is a bet that every founder will stay and contribute for as long as the company needs them. Vesting is how you stop making that bet.

- **Vesting** means a founder earns ownership over time. Unvested ownership goes back to the company, or can be bought back at a nominal price, if the founder leaves.
- **A cliff** is a waiting period before anything vests. A founder who leaves before the cliff takes nothing. One year is common.
- **The schedule after the cliff** is usually monthly or quarterly over three to four years. Shorter schedules suit smaller ventures and founders who have already proven themselves.
- **Acceleration** lets some or all unvested ownership vest early, typically on a sale of the company, and sometimes only if the founder is also let go after the sale.

Vesting protects the founders who stay. It is not a statement of distrust. Investors will usually ask for it anyway, and setting it up yourselves is cheaper than having it imposed.

Where the Terms Live

Before the company exists, the founders' deal is a contract among the founders themselves: who contributes what, how ownership will be divided and vest once the company is formed, who owns the work done in the meantime, and what happens if the company is never formed at all.

Once the company exists, vesting and buyback terms belong in the company's own documents: the operating agreement for a limited liability company, or a stock restriction or stock purchase agreement for a corporation. The company law of the state where it was formed governs those terms.

The 83(b) Election

If you receive equity that is subject to vesting, the tax law treats you as receiving it when it vests,

not when it is granted. Each vesting date can be a taxable event, valued at whatever the equity is worth on that date. In a company that is growing, that is the worst possible timing.

An 83(b) election lets you choose to be taxed on the full grant at the time of the grant, when the value is usually at or near zero. Later appreciation is then taxed only when you sell.

The election has to be filed with the IRS within 30 days of the grant. There is no extension and no late relief. The IRS now has a form for the election, Form 15620, and since mid-2025 it can be filed electronically through an IRS online account as well as on paper by mail. Use one method, not both. Calendar the deadline the day the equity is issued, give the company a copy of the filed election, and keep proof of filing with your company records.

Sweat Equity: LLC or Corporation

In a corporation, a founder who contributes services rather than cash receives stock. That stock is compensation, taxable at its value when received unless the 83(b) math works in your favor.

In an LLC taxed as a partnership, a founder contributing only services usually receives a **profits interest**: a share of future profits and future appreciation, but no share of the company's value as it stands on the grant date. Structured correctly, a profits interest is generally not taxable when granted. Structured incorrectly, it can be a taxable capital interest. Many advisors file a protective 83(b) election for profits interests as well.

Either way, the agreement has to say what the sweat-equity founder is contributing. "Will work on the business" is not a contribution anyone can measure. Hours, functions, deliverables, and what happens if they stop are.

When a Founder Leaves

Decide all of this in writing before anyone leaves:

- **What a departing founder keeps,** and whether the answer depends on why they left. Voluntary departure, termination for cause, death, and disability usually deserve different results.
- **The company's right to buy back vested ownership,** at what price, and on what payment terms.
- **Whether a departed founder keeps voting rights,** information rights, or a seat at the table. Usually they should not.
- **What happens to their role,** their access, and the accounts and relationships they control.

Intellectual Property Belongs to the Company

The most valuable thing an early company owns is often code, content, a brand, or a customer list that one founder created, sometimes before the company existed. If it was never assigned in writing, that founder may still own it.

Every founder should sign an assignment of prior work and an agreement that work done for the

company belongs to the company. Investors and acquirers check this first.

Special Situations

A founder with debts or in bankruptcy. Equity earned for work can belong to a bankruptcy estate or be reachable by a judgment creditor. Sort that out before the grant, not after.

Outside investors are coming. Taking money from investors raises securities questions, and many investors prefer a corporation. Plan the entity with the eventual raise in mind.

One founder funds, the other works. Cash and labor are both contributions. Decide how each is valued and whether the cash comes in as capital or as a loan that gets repaid first.

Related reading at bjoffrionconsult.com/blog: "One partner does all the work. How should equity handle that?" and "Taking equity for your work while you're in bankruptcy or behind on debts."

If You Want This Structured for Your Founders

Owners' Agreement — from $1,850. The founders' agreement, signed before the company is formed: who contributes what, how ownership will vest, decision rights, the money, IP, and what happens when someone leaves or the company never forms.

Document Review & Revision — from $1,400. For founders of a company that already exists: the vesting and buyback terms built into your operating agreement or stock restriction agreement, delivered as revised text. Where a revision turns on the company law of a state where I am not licensed, you engage an attorney licensed there, at your own expense, to advise on that question, and I build their advice into the document.

Entity Tax Classification Analysis — from $850. How the entity should be taxed, and what that means for sweat equity, profits interests, and founder compensation.

The fee for a consultation is credited in full toward any written work you commission within 30 days.

Full service list and current pricing: www.bjoffrionconsult.com/services

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