

July 22, 2019

Business Structure: The Strategic Use of Holding and Operating Companies to Protect IP

Related Practices

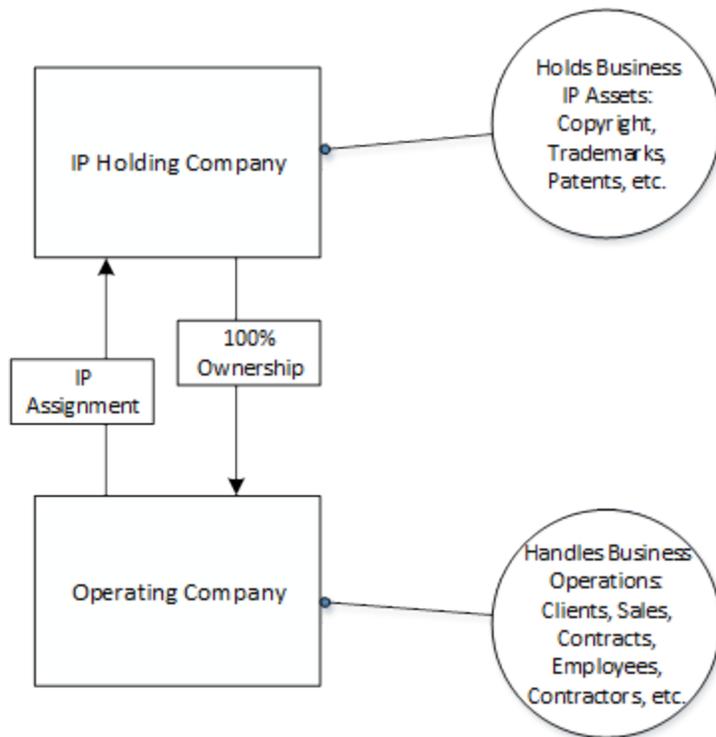
Fund
Grow
Sell
Start
Venture Capital & Private Equity

In today's digital economy, new technologies have fueled growth in intangible assets rather than physical assets. Intellectual property often represents the "crown jewel" of a company's assets, in terms of the revenue and success it could generate if properly protected. In fact, a study done by the Harvard Business Review estimates that intellectual property represents about 70% of an average firm's value. Designing the right business structure is therefore an important consideration for protecting a company's IP portfolio from theft, misappropriation, infringement, or even from potential creditors.

Businesses can limit liability and protect their valuable IP assets through strategic use of holding and operating companies. In an IP holding company model, the parent company establishes a wholly-owned subsidiary and then transfers ownership of its intellectual property to the newly created holding company. A holding company is essentially an entity that controls and owns the business group's assets such as patents, trademarks, copyrights, brand names, trade secrets, and proprietary information. Conversely, an operating company handles the day-to-day business activities and does not own any of the IP assets.

IP Asset Protection

Dual Corporate Structure Strategy



Forming these distinct business entities enables business owners to use the holding company to license their IP rights to affiliated operating companies or third parties. Centralizing the company’s IP assets creates efficiencies in administration, eases licensing or sales, and may even attract potential investment. This arrangement also ensures that the valuable IP portfolio is shielded from putative plaintiffs and creditors. For instance, in the event the affiliated operating company is sued, separation of intangible assets would likely protect that property from potential judgments in lawsuits. Without this additional layer of liability protection, business owners risk having their IP assets being subject to recovery in litigation.

When forming an IP holding company, it is important to select the proper type of business entity (e.g., C-Corp, S-Corp, or a Limited Liability Company). Business owners should consider which type of entity strategically maintains their intellectual property in a manner that best fits their business model. An LLC is a popular choice for structuring holding companies because the options defining the rights and obligations of the LLC members are often less restrictive than other business entities. When the IP is owned by multiple members, an LLC holding company can be effectively tailored to match those circumstances. On the other hand, IRS regulations on S-Corps create certain restrictions on shareholders and impose more operational requirements than LLCs in order to be compliant. The attorneys at Michael Best can help business owners determine the benefits of establishing a holding company and picking the appropriate business entity in various jurisdictions.

In sum, the division between holding and operating companies offers significant competitive advantages for a growing business. Securing IP assets in a holding company allows for better management and asset protection. Relatedly, the IP holding company and its appointed officers and directors are insulated from

liabilities of the parent company. Separating the IP assets in the holding company from the operations of the parent company could also benefit owners when obtaining financing and selling the intellectual property to a third party. Given these enumerated benefits, businesses seeking to effectively secure, exploit, and consolidate their intellectual property should consider housing them in holding companies.

Related People

Grace Jang

Law Clerk

ghjang@michaelbest.com

T 720.745.4866

Shawn Stigler

ststigler@michaelbest.com

T 303.731.2034

Shawn Stigler

ststigler@michaelbest.com

T 303.731.2034