

DOING BUSINESS IN

# USA



THE GLOBAL ADVISORY  
AND ACCOUNTING NETWORK

## FOREWORD

This booklet has been prepared for the use of clients, partners, and staff of HLB International member firms. It is designed to give some general information to those contemplating doing business in the United States and is not intended to be a comprehensive document. You should consult HLB, therefore, before taking further action. HLB USA, Inc. and HLB International cannot be held liable for any action or business decision taken on the basis of information in this booklet.

Federal laws of the United States that regulate business and income tax are numerous and complex. In addition, each of the fifty states and U.S. territories, as well as many local governments, have their own laws governing the conduct of commerce and companies, and each has their own tax laws. Therefore, you should consult an HLB International member firm in the United States and appropriate legal counsel before taking any specific action.

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Up-to-date information and general assistance on international matters can be obtained from any of the member firm partners listed in this guide or from the Global Office in London.

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## GENERAL INFORMATION

### GEOGRAPHY

The United States is comprised of 48 contiguous states, occupying approximately 7.7 square kilometers. Alaska, the 49th US state, is 1.5 million square kilometers in the Pacific North West, neighboring Canada. Hawaii is the 50th US state (comprised of the islands of Kauai, Oahu, Maui, Lanai, Molokai, and Hawaii) is approximately 3,400 kilometers west of US Pacific Coast. Territories of the US include the Virgin Islands, Guam, the Commonwealth of Puerto Rico, American Samoa, and minor Pacific islands.

Mountains, plains, deserts, fertile soils, minerals, and fossil resources with a variety of climates exist in the United States. Its altitudes reach a high of 6,198 meters (Mount McKinley, Alaska) and a low of 86 meters below sea level (Death Valley, California).

Certain areas of the United States are sparsely populated. For example, Alaska had an approximate population of 735,720 in 2019. Wyoming had approximately 572,381 residents in 253,335 square kilometers. These low populations are in contrast with the State of New York, which had just under 19.5 million residents in 141,297 square kilometers.

Factors to consider in deciding where to conduct business in the US should include, geography, population densities, ease of people and product transportation, and economic considerations. Americans frequently refer to regions of the U.S. by the following descriptive titles:

#### New England

Massachusetts, Connecticut, Maine, Vermont, Rhode Island, and New Hampshire. Second highest concentration of people (approximately 72 per square km). Major industries include tourism, education, some manufacturing, and fishing.

#### Mid-Atlantic

New York, Maryland, Virginia, Pennsylvania, West Virginia, New Jersey, Delaware, and the District of Columbia (the nation's capital, which is not a state). Heavily populated (approximately 80 per square km). Major industries include tourism, textiles, and manufacturing.

#### South

Texas, Georgia, Florida, Louisiana, Tennessee, South Carolina, North Carolina, Mississippi, Arkansas, Alabama, and Kentucky. Major industries include textiles, agriculture, resources, tourism, electronics, and new industry.

#### Mid-west (also called Central)

Wisconsin, Illinois, Ohio, Minnesota, Iowa, Nebraska, Missouri, North Dakota, South Dakota, Indiana, Kansas, Oklahoma, and Michigan. Major industries include agriculture, heavy industry, and manufacturing.

#### Mountain (also sometimes referred to as Western)

Colorado, Arizona, Wyoming, Utah, New Mexico, Montana, Nevada, and Idaho. Sparsely populated (approximately 5 per square km). Major industries include tourism, minerals, and other resources attracting greater investment interest in recent years.

#### Pacific

California, Oregon, Washington, Alaska, and Hawaii. Major industries include tourism, lumber, agriculture, electronics, high technology, and natural resources.

### GOVERNMENT

The federal government is a republic that derives authority from its citizens under a constitution adopted in 1787. It was first amended by the Bill of Rights in 1791, which provided individual civil rights through ten separate amendments. The constitution has 17 additional amendments, the last of which was proposed on September 25, 1789, and ratified on May 7, 1992.

The Federal Government is comprised of the executive, judicial, and legislative branches; each of which is discussed in detail below.

The chief executive of the U.S. government is the President. A term of office is four years; elections are held in even years 2016, 2020, etc. The President cannot be elected to office more than twice. The President's specified duties include acting as commander-in-chief of the armed forces, negotiating and signing treaties, appointing various federal officials, and executing and enforcing the laws of the federal government. In practice, the U.S. Presidency has assumed a powerful role in American government, accepting not only these specified constitutional powers but also taking on leadership positions such as: promoting his political party's legislative and political agenda; exerting influence on long-term economic and political trends; speaking for the U.S. in matters of world

importance; commencing limited military operations; operating a large bureaucracy of hundreds of departments and thousands of employees.

#### Legislative

The legislative branch of the U.S. government is bicameral. The House of Representatives (called "the House") has 435 members from 435 districts throughout the U.S. that are apportioned based on population. The Senate has 100 members (two from each state). Collectively, these two bodies are called "the Congress."

Members of the House are elected for two-year terms, with the entire House elected every two years; elections occur in even years 2018, 2020, etc. Senators are elected for six-year terms. Their terms are staggered so that only one-third of the Senate is elected every other even year. While there has been discussion to limit the number of times a member of the House or Senate may serve, no such limitation has ever been instituted. Proposed legislation must be passed by both the House and the Senate; and to be enacted into law, must thereafter be approved by the President. However, if the President disapproves (vetoes) legislation, such legislation can nevertheless be enacted with a two-thirds vote of approval by both the House and Senate. Any international treaties negotiated and signed by the president require a two-thirds vote of approval by the Senate in order to be binding.

### Judicial

The Supreme Court and other federal courts located throughout the United States exercise the judicial power of the U.S. government. The Supreme Court (SCOTUS) is the highest court in the federal judiciary, and has ultimate (and largely discretionary) appellate jurisdiction over all federal and state court cases that involve a point of federal law. SCOTUS can also rule whether laws passed by state or local legislative bodies conform with the intent and meaning of the U.S. Constitution.

### State and Local Governments

Each state has its own written constitution, and all state governments are modeled after the federal government in that they consist of three branches: executive, legislative, and judicial. In every state, the executive branch is headed by a governor who is directly elected by the people. Except for one state--Nebraska, which has one chamber--all states have a bicameral legislature made up of two chambers: a smaller upper house and a larger lower house. Together the two chambers make state laws and fulfill other governing responsibilities. State judicial branches are usually led by the state supreme court, which hears appeals from lower-level state courts. Local governments generally include two tiers: counties (also known as boroughs in Alaska and parishes in Louisiana), and municipalities (or cities/towns). Every state, except Louisiana bases its law on the "common law" that originated in England. Despite this more or less common legal heritage, the laws of the various states are different on a myriad of topics. Many states

have adopted uniform legislation for business entities and commercial matters. Most states have adopted the Uniform Commercial Code (abbreviated as "UCC") as their governing law for commercial transactions, but the courts of each state often interpret its various provisions differently so that its application often is not uniform.

### Political Parties

The two major political parties in the U.S. are the Democratic Party and the Republican Party. Other political parties exist, but they have often been a means of protest and a way to introduce social and other reforms.

Both major political parties trace their roots to the country's early political leaders. Some believe the Democratic Party to be one of the world's oldest political parties, having been established in 1792, and being connected with Thomas Jefferson. While the first Republican Party candidate to be elected President was Abraham Lincoln in 1860, the Republican Party's roots include a predecessor party ("the Federalists").

The Democratic Party is frequently described as the liberal party that emphasizes domestic social issues, and uses the power of government to experiment with solutions to societal problems and to raise the standard of living. The Republican Party is portrayed as the conservative party that promotes issues beneficial to business, and prefers to use free enterprise to maintain or improve the U.S. standard of living with minimal governmental regulation. In reality, these descriptions are not totally accurate. "Each major party has its inner contradictions and cannot be reduced to a simple formula."

Both parties include representatives of every economic, ethnic, and issue-oriented group, and neither party has a monopoly on "liberal" or "conservative" philosophies as they relate to modern domestic or international issues.

### POPULATION

The population of the US as of November 1, 2019 is 329,890,585.

The largest state in the US by population is California, which is estimated to be home to just over 39.5 million people. The largest city by population, and the most densely populated city in the US, is New York City with an estimated population of 8.4 million people.

Demographers predict the states that will add the most people in the next two decades are Arizona, California, Colorado, Florida, Georgia, Nevada, North Carolina, Texas, Virginia, and Washington.

### LANGUAGE

English is the predominant language used in the United States. However, 60 million Americans speak a language other than English at home. Of those, about 60 percent speak Spanish. Spanish is spoken and used in written documents, signs, advertisements, etc. where large populations of Spanish-speaking people live, particularly in Texas, Florida, some mountain states, and California.

### CURRENCY

The dollar is the medium of exchange; each dollar is 100 cents. Commonly used coins are pennies (1 cent), nickels (5 cents), dimes (10 cents), and quarters (25 cents).

The most commonly used paper denominations are the \$1, \$5, \$10, \$20, \$50, and \$100 "bills." Cents are commonly displayed in decimal form (i.e., 1 cent is \$.01; the zero before the decimal point usually is left out). While all U.S. paper currency is similar in size and color, the various denominations have recently been made more easily distinguishable than in the past.

## TRAVEL TO THE UNITED STATES

### Visas

Citizens of Andorra, Australia, Austria, Belgium, Brunei, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Monaco, the Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom may enter the U.S. without visas if they have tickets to return home in 90 days or less; they may enter for business or pleasure. All other non-immigrant travelers to the U.S. must obtain a visa that is appropriate for the nature of the visit. Such a visa may be obtained from a U.S. consulate office in the traveler's home country. Documentation of the visitor's permanent residence and proof of financial arrangements, which make it unnecessary for the visitor to work in the U.S., should be available when applying for a visa. Those who wish to work in the U.S. or live in the U.S. as traders or investors must have visas authorizing such activities.

Business visitors obtain a B-1 visa. These temporary business visitors may use a B-1 visa to negotiate contracts, take a product

order, consult with associates, attend a convention, perform research, attend a meeting of a board of directors if a member of a U.S. corporation's board, and engage in litigation. If the visitor receives any payment, other than reimbursed expenses, he may not qualify under the B-1 visa category and must obtain a temporary worker visa.

Entry on a B-1 visa can be granted for up to one year with six month extensions available. In addition to the documentation of residence and finances mentioned above, the visa application should include a letter from the traveler's employer explaining the business purpose of the travel and stating that the foreigner will not need to obtain employment in the U.S. for financial support.

A temporary visa to visit the U.S. for pleasure is a B-2 visa. The B-2 visa category includes tourists, those seeking medical treatment, persons attending non-business conventions, and amateur entertainers and athletes. For most European countries that do not require visas from U.S. citizens to visit, visas are granted for an indefinite duration. At the point of entry, visitors are usually admitted for six months. Extensions are available.

Other visas are issued for the purposes of treaty traders, treaty investors, employees, etc. and are discussed in this booklet under the heading "Immigration Law for Foreign Employees and Investors."

## BUSINESS HABITS

Americans are informal. The use of given names ("first names") is common, even between subordinates and managers.

Titles, except for medical doctors, are generally not used. Business is often conducted over breakfast, lunch, or dinner.

Business entertainment may be conducted at relaxed events such as sports events, dinner parties, or even in personal residences. Business hours are usually from 8 a.m. or 9 a.m. to 5 p.m. (17:00h) or 6 p.m. (18:00h). Businesses do not close during the lunch period, which usually lasts an hour and ranges from about 11:30 to 1:30 p.m. (13:30h). Most Americans eat dinner at approximately 7 p.m. (19:00h).

## LEGAL ENVIRONMENT

The legal environment in the United States is very favorable to doing business. The regulatory environment is generally less burdensome than in most countries of the developed world and, regulatory staff are, comparatively speaking, easily accessible. Regulations affecting several specific industries (such as banking and transport) exist.

Great emphasis is placed on the freedom of commercial parties to make their own agreements. Parties generally may freely deviate in their arrangements from the Uniform Commercial Code adopted by the individual states, and courts are usually reluctant to set aside provisions of written agreements for commercial unfairness. In general, an agreement will be set aside only if there is a clear and specific statutory basis for doing so (such as charging excessive interest), if there are clearly expressed upper court decisions concerning a similar clause (such as restrictions on the geographic

and temporal scope of covenants against competition), or if the agreement or clause is illegal or against public policy.

Consumer protection laws exist, but they are generally much more business favorable than they are in many other countries.

The United States does regulate international trade, including imports, exports (especially with respect to advanced technology and military items), dealings with certain countries posing a risk to national security, and payment flows (e.g., money laundering). Some of these rules also either have or seek to have an extra-territorial effect, and as a result, a U.S. presence (such as a subsidiary) may have an impact on how and with whom a non-U.S. company (such as a parent of a U.S. subsidiary) may conduct its business.

Use of litigation in the United States to solve commercial disputes is well known. Especially burdensome, expensive, and time consuming are the infamous U.S. discovery rules, under which parties must disclose all potentially relevant documents and make all potentially relevant witnesses available to the other parties to the dispute. However, despite the "litigiousness" of Americans, the risk and expense of litigation should not be an impediment to conducting business in the United States; most businesses successfully operate for many years absent litigation of any kind. Especially in cross-border transactions, arbitration instead of litigation has become the preferred way to formally resolve disputes. This is because enforcing non-U.S. judgments in the U.S. is much more difficult than enforcing

arbitration awards and because arbitration is often more flexible than a court proceeding. For instance, the parties can agree on the qualifications of the arbitration panel. They can also tailor how their arbitration proceeding will operate in order to avoid application of the U.S. discovery rules.

Receiving competent legal advice when contemplating whether to conduct business in the U.S. or with U.S. parties is as critical for risk management as it is with respect to doing business in any other jurisdiction.

## ECONOMIC ARRANGEMENTS

### Imports and Exports

The U.S. is a member of the General Agreement on Tariffs and Trade (GATT) and several other international economic associations. The United States is an active export and import country.

In 2018, US exports of goods and services totaled \$2,500 billion, and its imports totaled \$3,121 billion. The U.S. had record exports to 53 countries in 2018 led by Mexico (\$265.0 billion), Japan (\$75.0 billion), and the United Kingdom

(\$66.2 billion). The U.S. had record imports from 60 countries in 2018 led by China (\$539.5 billion), Mexico (\$346.5 billion), and Germany (\$125.9 billion).

### North American Free Trade Agreement

In 1992, Canada, Mexico, and the United States entered in the North American Free Trade Agreement ("NAFTA"). The agreement generally reduced or eliminated tariffs, export taxes, duty waivers, customs fees, and other trade barriers between these countries.

In September 2018, the United States, Mexico, and Canada reached an agreement to replace NAFTA with the United States-Mexico-Canada Agreement (USMCA). NAFTA will remain in force, pending the ratification of the USMCA.

**Foreign Investment in the U.S.**

The major sources of foreign direct investment in the U.S. are Japan, United Kingdom, the Netherlands, Canada, Germany, France, and Switzerland.



## INVESTMENT FACTORS

### GOVERNMENTAL POLICY AND INCENTIVES

The federal government allows investment in the U.S. consistent with the needs of the country. This attitude basically treats foreign capital on the same basis as U.S. capital. Any investment in the U.S. should be made based on sound commercial practices, since there are no taxes or other special privileges given to investors on the federal level merely based on the fact that they are foreign.

Investments by non-U.S. individuals or companies are limited in national security matters such as atomic energy and defense, communications, banking, and some other business areas. There are other restrictions: some states prohibit the sale of land (usually agricultural) to foreign investors; certain real estate managed by the federal government cannot be sold to foreigners; the sale of agricultural land to a foreigner must be reported to the Secretary of Agriculture. Legal counsel should review any proposed investment to be certain it is not restricted or limited by federal or state law.

A foreign business operating in the U.S. is entitled to obtain the same federal government-sponsored assistance to business (such as programs of the Small Business Administration) that exists for domestic operators and the same basic tax treatment. Many state and local governments offer aggressive incentives to attract businesses to their particular area. Such incentives commonly include income and real estate tax concessions, financing, and sometimes opportunities to purchase or lease operating facilities at greatly reduced prices.

Some states have created offices to promote investment in their state and to provide information on current incentives and other possibilities. The United States Chamber of Commerce also provides investment information and publishes material on business in the U.S.; this organization can be contacted at U.S. embassies or consulate offices.

### LABOR AND POLITICAL ATTITUDES

American workers do not resent foreign ownership of businesses unless jobs are threatened. Conversely, if foreign investment creates jobs, it is heartily welcomed. Some politicians occasionally express concern about foreign investments in the U.S., but broad investment restrictions are not seriously contemplated.

### SOURCES OF FINANCE

An investor should review sources of government-sponsored financing that might exist at the time investment is considered. Other traditional sources of financing are banks, private equity funds, the equity market, and other lenders or investors.

The most common financial institutions are:

**National banks.** National banks operate under a federal charter. They do not maintain offices nationwide as do large banks in other countries, but may operate in more than one state. They are required to operate under the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC). FDIC deposit insurance covers the depositors of a failed FDIC-insured depository institution dollar-for-

dollar, principal plus any interest accrued or due to the depositor, through the date of default, up to at least \$250,000. A national bank is also regulated by the state in which it operates.

**State banks.** State banks function under a charter granted by the state government and are regulated by the state banking commission. Most state banks voluntarily belong to the Federal Reserve System and the FDIC. The distinction between national and state banks is disappearing.

**Savings and loan associations.** These entities historically operated savings accounts for individuals and made loans to finance the purchase of personal residences. These institutions now operate as commercial banks in many respects. They may be organized under state or federal charters, but state-chartered and federal-chartered associations are regulated by the Office of Thrift Supervision (OTS), a bureau of the U.S. Department of the Treasury. Most associations are insured under the FDIC.

**Credit unions.** Credit unions resemble savings and loan associations, but are organized by and for a specific group, usually the members of a church, the employees of a company, etc. Credit unions provide inexpensive credit to members.

There are a few banks in each major U.S. city that offer international banking services; your HLB International representative can recommend a bank suitable to your needs.

**Life insurance companies.** These insurers offer a variety of financial products, such as life, health, and disability insurance,

annuities, investment funds, etc. These institutions invest vast amounts in stocks, bonds, real estate, mortgage loans, etc. while they await eventual long-term claims.

**Stock brokerage and investment banking houses.** (also referred to as “broker-dealers” or “investment underwriters.”) These entities represent customers for whom they purchase stocks, bonds, and other investments and earn a commission for doing so. These institutions also function as advisers for businesses in a variety of sophisticated financial transactions and as investors or sales representatives for businesses that obtain equity by selling securities to the public.

### Borrowing

In the U.S., a bank borrowing usually is made with a signed loan agreement and a note payable promising to repay the loan on a certain date (or dates if monthly, quarterly, or annual payments are made) at a defined interest rate. In addition, the bank and its customer will execute various documents securing any collateral pledged to secure the loan.

Banks offer various loan products to their customers depending on customer need, creditworthiness, and purpose. Arranging for individually tailored levels of debt is also customary. The most basic forms of bank debt (from which most of today's loan products are derived) are:

**Lines of credit.** Short-term in nature to finance seasonal cash flow requirements; amounts are borrowed and repaid periodically. A fee may be charged to



establish and maintain a line of credit. Interest rates are usually fixed, but may vary according to a published index. Often the prime interest rate, ("the rate of interest a bank charges its most favored and financially strong customers,") is used. Many lines of credit require the debtor to be out of debt to the bank for a number of days each year to ensure that the loan is used only for short-term financing purposes. Designated assets often act as security for the loan. A specified savings or checking account balance may be required ("compensating balance") for the loan's duration. Lines of credit with a longer term of up to several years are known as revolving lines of credit.

**Term loans.** Specify a maturity date usually of one to ten years, with monthly or quarterly principal and interest payments; used to finance expansion or other long-term needs that cannot be financed with a line of credit. Interest charged relates to the creditworthiness of the borrower and may float with an agreed upon published rate.

**Leasing.** An alternative to ownership or other financing methods. Under an "operating" lease, the lessee makes rental payments for a specified period of time, after which the asset is returned to its owner (lessor). Under a "capital" lease, the lessee makes payments under a non-cancelable agreement and has the option to purchase the asset at the end of the lease term for an amount which generally had been pre-determined. Interest imputed under lease arrangements is usually higher than under loan arrangements.

**Bankers' acceptance.** Used to finance the purchase of goods on a short-term basis and usually in conjunction with a letter of credit. As soon as the transaction is accepted and title has passed, the banker's acceptance can be sold ("discounted.") U.S. exporters can obtain assistance from the Export-Import Bank of Washington (Eximbank), a government agency. Eximbank finances, guarantees, and insures payment for goods of U.S. origin. The Foreign Credit Insurance Association (FCIA) offers export credit insurance. Other federal agencies enter into the export arena to assist with trade to developing nations, emergency situations, etc.

#### **Raising equity**

**Private equity financing.** Since 2002, private equity financing has once again become less available to most companies, but remains a possible source of financing if the business plan is sound, the principals proper, and the transaction structure favorable.

Companies may prefer private equity over bank lending because the investment will usually be structured with an exit in mind instead of repayment over time. Private equity investors may also promise to obtain financial and operational expertise which banks are unable to provide. Much like a bank, financial investors will typically dictate many of the terms of the investment, and the company should evaluate the reputation and strength of the investor with the same thoroughness as the investor would evaluate the company.

**Going public.** A company may also issue and distribute its stock (or other equity interests) by "going public." This generic term is synonymous with the term "flotation" and means selling shares of stock to "the public." "The public" is a broad technical term that generally means outside investors who are not presently owners of the business. Stock of a company that has gone public can be easily transferred or sold because it is normally valued in some market. A company that has gone public is referred to as "publicly-held" in contrast to non-public companies, which are referred to as "closely-held" or "privately-held" companies.

Legal issues arising when selling equity securities.

U.S. securities laws are very complex. Before taking any action to raise equity in the U.S., consult a competent attorney who is skilled in the many intricacies of selling stock to outside investors. If the amount to be raised is significant, an investment banker should also be engaged at an early stage of the effort.

That said, the Securities Act of 1933, as amended, (the "Securities Act") governs all sales of securities by a company (it does not cover sales among investors). The Securities Act established the basic rule that no stock or other security may be offered or sold unless the U.S. Securities and Exchange Commission (the "SEC") (or an applicable state agency, as the case may be) has approved a formal "registration statement" of a company "going public" or unless the security is exempt from registration.

**Offerings exempt from registration.** If a limited number of investors or very sophisticated investors (such as financial institutions, venture capitalists, private equity funds, or high net worth individuals) are asked to consider making an investment, or if the equity to be raised is less than specified amounts, the security can be exempt from registration with the SEC. Potential investors should be provided with a "private placement memorandum" that describes the offeror, its directors, officers, use of the equity funds, etc. These securities are not easily transferred between parties (as they contain regulatory restrictions on transfer) and are not valued in a trading market.

Companies may also sell their securities without SEC registration if the sale is made outside of the United States and certain other rules are followed. Non-U.S. companies undergoing a public offering in their home jurisdiction and wishing to sell their securities in the U.S. without seeking a U.S. listing usually sell their securities to "qualified institutional buyers" pursuant to Rule 144A. Under this mechanism, applicable regulatory transfer restrictions will be valid only for a period of time after which they trade freely and without need of registration.

**Going public and registered offerings.** If the offering of securities is not structured to fit within one of the several registration exemptions, the Securities Act deems that the company is selling its securities to the "public." A company that is "going public" must file "registration statements" with

the SEC and perhaps with state agencies. This process requires audited financial statements prepared pursuant to U.S. generally accepted accounting principles (“U.S. GAAP”), as well as significant disclosures about the company (referred to as “the registrant”) and its directors and officers. These disclosures are contained in very detailed “prospectuses” that also explain the uses of the funds sought to be raised in the offering of equity securities.

A company may start out having its equity traded on the over-the-counter (“OTC”) market (a mechanism established by professional securities traders) and may, assuming certain listing criteria are fulfilled, ultimately grow and seek a listing on a prominent stock exchange. Achieving a listing on the New York Stock Exchange, NASDAQ, or the American Stock Exchange is very prestigious and is possible only after meeting strenuous exchange listing requirements.

Ongoing reporting obligations. Once a company is a publicly-held company, it is required to comply with strict ongoing reporting obligations pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Audited financial statements prepared pursuant to U.S. GAAP must be filed, including detailed annual reports on the operations of the company and its relationship with insiders. Such reporting requirements generally apply also to non-U.S. companies that meet certain asset tests and that have more than the requisite number of U.S. shareholders.

Because of public reporting scandals that rocked the U.S. investment community in 2002, Congress passed the Sarbanes-Oxley Act which was enacted on July 30, 2002. Sarbanes-Oxley applies to nearly all U.S. and non-U.S. reporting companies, and presents the most significant revision to ongoing reporting obligations since the Exchange Act was enacted after the Great Depression. Sarbanes-Oxley is intended to make public company reporting even more transparent.

Chief executive officers and chief financial officers are required to review financial reports, and certify reports, among other things, do not contain any untrue statements of material fact; are not misleading; disclosure controls exist and are effective; and that the information fairly represents the financial condition, result of operations, and cash flow of the company.

Personal loans to directors and executive officers are now prohibited. Executive compensation and share dealing are also more closely regulated.

Each U.S. listed company must now have an audit committee. Requirements apply as to how the audit committee is constituted.

Much has been made about auditor independence, and Sarbanes-Oxley now regulates by statute the circumstances under which an audit firm may accept an audit mandate and how personnel may move between audit firm and public company. To enforce this provision of the law, Sarbanes-Oxley has established the Public Company Accounting Oversight Board, which now

effectively regulates all accounting firms that audit publicly traded companies in the US.

Member firms of HLB International will be able to refer you to the appropriate attorneys and investment bankers for securities law and other required legal advice.

### FOREIGN EXCHANGE CONTROL

The United States does not impose any exchange controls and a foreign investor can repatriate capital, loans, and income. Some payments, such as dividends, interest, royalties, and service income may be subject to a withholding tax (see the “Taxation” section in this booklet). The rate of exchange between the dollar and other currencies is not controlled by a U.S. national bank; the dollar is valued in relationship with other currencies in a worldwide market. Currency transactions of more than \$10,000 must be reported to the Internal Revenue Service on form number 8300 by the recipient within 15 days after receipt. Currency includes cash equivalents such as cashiers’ checks and foreign currency. Since September 11, 2001, the U.S. has significantly tightened its anti-money laundering regulations and thus also its regulations affecting financial transactions.

### IMMIGRATION LAW FOR FOREIGN EMPLOYEES AND INVESTORS

As previously mentioned, all visitors must have a proper visa to enter the United States. This is so unless they are citizens of the 27 countries for whom a 90-day stay for

business or pleasure is visa exempt under the Visa Waiver Program (VWP). (See the section on “Travel to the United States” in this booklet.) Those who wish to work in the U.S. or live in the U.S. as traders or investors must have visas authorizing such activities.

### Treaty Traders (E-1)

This visa allows an alien to reside in the U.S. to carry on significant trade between the U.S. and the alien’s own country. Certain countries have treaties with the U.S. which allow their citizens to obtain an E-1 visa. They are Argentina, Australia, Austria, Belgium, Bolivia, Bosnia, Brunei, Canada, Chile, China (Taiwan), Colombia, Costa Rica, Croatia, Denmark, Estonia, Ethiopia, Finland, France, Germany, Greece, Herzegovina, Honduras, Iran, Ireland, Israel, Italy, Japan, Korea (South), Kosovo, Latvia, Liberia, Luxembourg, Macedonia, Mexico, the Netherlands, New Zealand, Norway, Oman, Pakistan, Philippines, Poland, Serbia, Singapore, Slovenia, Spain, Suriname, Sweden, Switzerland, Thailand, Togo, Turkey, and United Kingdom.

The company must be majority-owned by citizens of the employee’s own country. The employee must be in a supervisory or executive position or have skills essential to the company’s operations. Trade may be in goods or services. An E-1 visa grants unlimited entry for a period of several years, depending on the alien’s country, and two year extensions are available for as long as the trade continues and the treaty is in effect.

**Treaty Investors (E-2)**

This visa is for citizens of treaty countries who make a significant investment in the U.S. The venture must be majority-owned by the foreign citizen and they must have an active roll in the investment; the trade between the U.S. and foreign country must be “substantial.” Otherwise the E-2 is similar to the E-1. E-2 countries include Argentina, Albania, Armenia, Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Belgium, Bolivia, Bosnia & Herzegovina, Bulgaria, Cameroon, Canada, Chile, China (Taiwan), Colombia, Congo (Brazzaville), Congo (Kinshasa), Costa Rica, Croatia, Czech Republic, Denmark, Ecuador, Egypt, Estonia, Ethiopia, Finland, France, Georgia, Germany, Grenada, Honduras, Iran, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Korea (South), Kyrgyzstan, Latvia, Liberia, Lithuania, Luxembourg, Macedonia, Mexico, Moldova, Mongolia, Montenegro, Morocco, the Netherlands, New Zealand, Norway, Oman, Pakistan, Panama, Paraguay, Philippines, Poland, Romania, Senegal, Serbia, Singapore, Slovak Republic, Slovenia, Spain, Sri Lanka, Suriname, Sweden, Switzerland, Thailand, Togo, Trinidad & Tobago, Tunisia, Turkey, Ukraine and United Kingdom.

**Workers Having Specialty Occupations (Professionals) (H-1B)**

Workers in specialty occupations can be admitted to the U.S. under this visa. Holding a Bachelor of Arts or science degree in a professional discipline can usually qualify an applicant under this category. While the employer does not have to demonstrate

that no U.S. citizen is available to perform the job, the employer must attest to the U.S. Department of Labor that the alien will be paid either the prevailing wage for that occupation or the actual wage paid by the employer for persons in the relevant occupation, whichever is higher. The employer must also show that the position requires a person of professional ability, and that the proposed employee has sufficient credentials. This visa is initially available for up to three years with extensions to six years possible. If a green card application is in process, an additional one year extension is possible.

**Intracompany Transferees (L-1)**

This visa category is used for an alien who has worked for a related company outside the U.S. for at least one year within the previous three years. The employer must be an international company doing business in the United States and at least one other country through a subsidiary, parent, affiliate, or branch office. The intracompany transferee category is available for executives and managers. Individuals with specialized knowledge may also qualify. The initial visa is issued for a three year period. It is possible to obtain extensions of up to seven years for managers and executives. Non-management holders of specialized knowledge are limited to a five year stay.

**Foreign Students (F-1)**

A foreign student can easily obtain approval for academic learning in the U.S. They must attend full- time and have a valid educational reason for coming to the U.S.

**Temporary Worker (H-2)**

This category is for temporary workers whose skills are in short supply, and the time required to perform the job is of limited duration. This visa is more difficult to obtain than the H-1 B because the employer must apply to the Department of Labor for evaluation of the availability of U.S. workers to perform the job. The H-2 visa is for an initial period of one year with extensions available up to three years.

**Trainees (H-3 and J-1)**

Temporary trainees can be admitted under an H-3 visa and trainees sponsored by an exchange program can be admitted with a J-1 visa. The H-3 is normally used to train an individual from a foreign country in a process that can be learned only in the United States. The program must include substantial classroom- style teaching and be relatively unproductive; such employment must not displace a U.S. worker. An H-3 visa is granted for the length of the training program, up to two years. A J-1 visa is for a student, scholar, trainee, teacher, or any other person coming to the U.S. to participate temporarily in a program authorized by the Department of State’s Exchange Visitor Program.

**Other Visas (O, P, Q, and R)**

U.S. immigration law authorizes a number of additional non-immigrant visas that permit work in the United States. An alien with extraordinary ability in the sciences, arts, education, business, or athletics may be eligible for the O visa. Athletes, entertainers, and other performers may be eligible for

P visas. Q visas are available to work in an international cultural exchange program; the Q program may be privately sponsored. A religious worker may seek an R visa to work for a temporary period in the United States. Each visa has special eligibility criteria and time limits.

**Permanent Residence (Green Card)**

An employer that wants to permanently hire a foreign individual to work in the United States faces a complicated process. Permanent residence may be granted to special immigrants, immediate relatives of U.S. citizens, “close” relatives of citizens and permanent residents, and, most important to business, to persons with offers of permanent employment in the United States.

In most cases an employer must first prove, through a process known as “labor certification,” that no U.S. worker is available for the position. If a particular foreign individual has had sustained national or international renown, is an outstanding professor or researcher, or is a multinational company’s executive or manager, that step may be eliminated.

Individuals holding advanced degrees or having exceptional ability may immigrate. Professionals holding bachelor’s degrees and persons in skilled occupations requiring two years of training or experience may also immigrate. Employers may also petition for unskilled workers. In almost all cases an employer must demonstrate an inability to find a U.S. worker.

U.S. immigration law authorizes 140,000 employment- based immigrants per year.

Processing time will likely take from one to four years, assuming all eligibility requirements are met. For this reason, many people enter first in one of the nonimmigrant classifications discussed previously.

#### EB-5 VISA

An immigrant investor must file an initial immigrant petition and supporting documentation to receive EB-5 immigrant classification. The immigrant investor will be a conditional permanent resident upon adjustment of status or admission to the United States.

#### PARAGRAPH

The petitioner must establish he or she meets the following eligibility requirements when filing the Immigrant Petition by Alien Entrepreneur (Form I-526): (1) The required amount of capital has been invested or is actively in the process of being invested in the new commercial enterprise; (2) the investment capital was obtained by the investor through lawful means; (3) the new commercial enterprise will create at least 10 full-time positions for qualifying employees; and (4) the immigrant investor is or will be engaged in the management of the new commercial enterprise.

#### PARAGRAPH

If the immigrant investor seeks to qualify based on a \$500,000 investment, instead of \$1,000,000, it is necessary to show the new commercial enterprise or job-creating entity, as applicable, is principally doing business in a targeted employment area (TEA).

#### Caution

The U.S. immigration law is complicated. Like all laws, it is subject to change at any time. Before taking steps to obtain a visa under any of the categories discussed above, one should obtain advice from an attorney who specializes in immigration issues.

### IMPORT AND EXPORT OF GOODS

#### Imports

Most imports are free of restrictions, but quotas are imposed for some products. Quotas may be absolute (allowing a maximum quantity of a product during a time period) or variable rate (resulting in a higher rate of duty on quantities in excess of a certain amount). From time to time, imports from and exports to certain countries may be restricted or embargoed. Names of such countries are available from legal counsel.

A license or permit must be obtained to import certain goods, some of which are subject to product safety and health controls. Most goods imported into the U.S. are subject to an import duty. The method used to assess tariffs under the Harmonized Tariff Schedule is very complex. Anyone exporting to the U.S. should obtain a ruling on the tariff classification and the rate of duty on specific items from the Commissioner of Customs before commencing business. This will reduce delays at the port of entry and will prohibit surprise calculations.

#### Contract Law

It is important when selling goods in the United States that the contracting parties choose the law that will govern the transaction. Choices include the law of the seller's country, or the law of the buyer's state of residence (individual or business). Most U.S. parties will want to exclude the application of the United Nations Convention on Contracts for the International Sale of Goods ("CISG"). Most courts in the U.S. will honor a choice of law designated in a contract unless it is unreasonable. In addition, the parties to the contract can modify the default provisions of the governing law by mutual agreement. Without choosing governing law, a contract dispute is left to uncertainty.

#### Relief Provisions

Selling products in the U.S. at less than the product's fair market value, selling heavily subsidized products, violating patent or similar laws, and injuring a U.S. industry can be reasons for a U.S. business to seek relief against a foreign competitor. Such relief could result in the foreign company's payment of hardship duties on its products. Foreign exporters and domestic importers should become familiar with these provisions to avoid unhappy and expensive situations.

#### Marking

The U.S. requires that foreign products imported into the U.S. be marked with the country of origin. Failure to do so can result in the imposition of additional duties. Complexities include products that are made

in more than one country. Foreign sellers and domestic importers should seek advice and assistance from legal counsel and customs brokers regarding this important requirement.

#### Foreign Trade Zones and Bonded Warehouses

"Foreign trade zones" (FTZs) are areas that are legally outside the customs territory of the United States. Similar to free trade zones throughout the world, these areas are used by importers and exporters to store, manufacture, exhibit, label, package, sort, and modify goods before selling them. Duties are paid on these items only when they are imported into the market out of these zones. An additional benefit is that the customs valuation does not include the processing value added to the goods while in the FTZ.

A "customs-bonded warehouse" may receive goods free of duty. Similar to a foreign trade zone, but with less flexibility as to the types of activities that may be performed, a warehouse may save significant duties. The importer and the warehouse operator obtain a bond to guarantee payment of duties.

#### Duty Drawbacks

Duty drawbacks are often overlooked. Duties paid on imported merchandise may be refunded if the merchandise is later exported.

#### U.S. Goods Returned

U.S. goods that are exported and returned to the U.S. (including articles assembled, processed, or refined abroad which utilize

U.S. metal articles or other components) receive preferential tariffs.

#### U.S. Manufacturers Seeking to Export

Many smaller U.S. manufacturers have not seen the need to export their products because of the vastness of the U.S. market. More and more smaller manufacturers now realize either that exporting is essential to their survival or that foreign markets provide significant opportunities. They have found that by selling internationally they have improved economies of scale in production, marketing, and distribution and have increased profits. U.S. manufacturers have also learned that by responding to the preferences of foreign customers and the innovations of foreign competitors, they are better able to compete for sales at home. As a result of these attitudes, a variety of U.S. products are available to sell internationally. Contact the U.S. Embassy or consulate office in your area or your HLB International representative for additional information about U.S. manufacturers seeking to export products.

#### Export Regulations

The U.S. does have regulations governing exports. Each export must either be licensed by the Department of Commerce, the Department of State, or other applicable agencies or must be exempt from licensing. The vast majority of exports are made pursuant to a license exemption. High technology items, weapons and chemicals are almost always subject to higher scrutiny. Goods which when exported could have an effect on national security (such as electronics that are capable of being used

in military applications) will nearly always require a license. The U.S. also restricts sales to certain "denied" parties, no matter what the product. Most freight forwarders are familiar with the export rules currently in force and will be able to assist with the necessary documents. Structured re-exports in third party countries to avoid U.S. restrictions also are prohibited and will prevent a foreign company from dealing with U.S. companies in the future.

Civil and criminal penalties apply for exporters who sell the wrong goods to the wrong persons. Sanctions can include a general prohibition for a company to export its products from the United States and for a company to make sales to the federal government. It is therefore critical for any U.S. company (including U.S. subsidiaries of foreign companies) to have in place an up-to-date export compliance program.

#### EMPLOYMENT REGULATIONS

Federal, state, and local laws regulate employment in the United States. The federal government regulates employment through the Fair Labor Standards Act, the National Labor Relations Act, the Equal Pay Act of 1963, the Civil Rights Act of 1964, the Age Discrimination in Employment Act, the 1992 Americans with Disabilities Act, and other legislation. The federal agencies that regulate employment are the Department of Labor, the Equal Employment Opportunity Commission, and the National Labor Relations Board. Each state has corresponding agencies.

Important matters that may be regulated by federal or other authorities and that one should consider when establishing a business or hiring employees for the first time include:

- Minimum wages
- Overtime pay
- Holiday pay\*
- Vacation and sick pay\*
- Rest periods\*
- Fringe benefits
- Term of employment\*\*
- Child labor
- Termination pay
- Military service, voting, disability, maternity, and jury leave
- Workers compensation insurance
- Written employment agreements
- Collective bargaining agreements and unionization
- \* Not mandated by the federal government
- \*\* Generally "at will" in the U.S.

#### OTHER REGULATIONS

Federal, state, and local agencies with thousands of regulations influence business. An all-inclusive list is beyond the scope of this booklet, but examples of matters which are regulated include: the environment; safety of workers; usefulness and safety of pharmaceuticals; access to business facilities by physically handicapped or disabled persons; ingredients of food products; trademarks, patents and copyrights; monopolistic and anti-trust practices; safety of transportation; plant closings or mass layoffs. No matter what enterprise one might enter, one should make a search for all the laws which impact that specific business to avoid major oversights. The assistance of competent legal counsel is critical.

## ESTABLISHING A BUSINESS

The primary US business structures, which are similar in title and operation to those in other countries, include sole proprietorships, partnerships, corporations, limited liability companies, branches, and joint ventures.

### SOLE PROPRIETORSHIPS

A single individual owns and operates the business. The proprietor is personally responsible for all liabilities of the business, is entitled to all of the income earned from the business, and pays individual income tax at graduated rates on such income. No legal action is required to establish a sole proprietorship other than registering the business trade name. However, the company will need to register for authority to do business in the state it is incorporated, and any state(s) in which it conducts business activities; and may have to register for payroll related taxes and/or sales tax.

There are no governmental fees to establish a proprietorship. This informal business structure requires the taxpayer to maintain adequate records in order to calculate net income for tax purposes (the proprietor also should require good records for management purposes); such records may consist of worksheets summarizing income and expenses using sales slips, bank deposit records, canceled checks, and similar items to document transactions. There are no statutory audit requirements, but lenders, sureties, and others may require audits.

### PARTNERSHIPS

A partnership is an association of two or more individuals or entities operating a

business. Partnerships are formed under a specific state's law (state of business residence). Partnerships should have a partnership agreement that describes the responsibilities and benefits to each partner, nature of the business, governing law, and more. Partners are jointly liable for the partnership's debt. Partners are taxed on their proportionate share of partnership income; unless the partnership elects to be taxed as a corporation.

Most states permit a special arrangement of partnerships called limited partnerships. In these partnerships, a limited partner (or more than one) is liable for the debts of the partnership only up to the amount of his capital. Limited partners do not participate in controlling the affairs of the limited partnership. There must be at least one general partner who is not protected by limited liability.

Both general and limited partnerships are treated as partnerships for tax purposes so that income passes through to the partners, unless the partnership elects to be taxed as a corporation.

There are usually no stated costs to establish a partnership (there may be small registration fees for limited partnerships), but legal counsel should be consulted regarding the preparation and adoption of the partnership agreement and the necessity to register the partnership with a state or local governmental agency. Accounting, at a minimum, should allow the computation of net income for tax purposes; double entry accounting records are recommended. Many partnership agreements require that

financial statements be prepared according to generally accepted accounting principles. Some partnership agreements require that the financial statements be audited or reviewed by independent accountants, but there are no statutory audit requirements unless the partnership's equity interests are publicly traded (see section on raising equity). Audits may be required by lenders and other outside parties.

### CORPORATIONS

The incorporated business is a distinct entity from its owners, (the "stockholders" or "shareholders,") who are not personally liable for the debts and actions of the corporation. This is the most formal means of conducting business, and is preferred by foreign companies doing business in the U.S. because of U.S. tax law and insulation from legal claims. Corporations, which are "incorporated" under state law by filing "articles of incorporation" with the proper state agency, can exist perpetually even when the stockholders transfer their ownership to others. Corporations operate under the general direction of a board of directors which establishes the policies under which the officers conduct daily corporate business.

There are no restrictions on ownership of corporations. The U.S. corporation may be a subsidiary that is wholly-owned by foreigners. There is no foreign investment approval process, and there is no citizenship or residency limitation on directors or management. Except for certain industries, there are few minimum capital requirements, and a corporation may have only one

shareholder. Unless a corporation is a "public" company, it is customary to have a shareholders' agreement governing the relationship among the shareholders, much like a partnership agreement governs the affairs of partners.

Each state has established a fee schedule for the incorporation of a corporation and the services of legal counsel are usually required to assist with the incorporation process. Accounting records should be formalized and use double entry accounting. There are no statutory audit requirements unless the company's stock is publicly traded (see section on raising equity). Lenders and other interested parties may require audited financial statements.

S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates; this allows S corporations to avoid double taxation on the corporate income.

To qualify for "S" status, the corporation must: be a domestic corporation; have only allowable shareholders (can be individuals, certain trusts, and estates, but cannot be partnerships, corporations or non-resident alien shareholders); have no more than 100 shareholders; have only one class of stock; not be an ineligible corporation (i.e. certain financial institutions, insurance companies, and domestic international sales corporations).

## LIMITED LIABILITY COMPANIES

The limited liability company (often called an “LLC”) is a newer form of entity that combines limited liability for owners (called “members”) like that of a traditional corporation, except that LLCs have significantly more structural flexibility. In addition, LLCs are taxed (despite their limited liability character) as a tax partnership, unless the members elect to be taxed as a corporation.

An LLC is formed by filing organizational documents with a state agency.

“Operating agreements” or “LLC regulations” define the rights and powers of the entity’s members and designate the management of the LLC; these documents are the equivalent of a partnership agreement, corporate by-laws, or shareholder agreements.

If an LLC is owned 100 percent by a single owner it is referred to as a single member LLC (SM LLC). For US income tax purposes the LLC is disregarded (unless it elects to be taxed as a corporation) and all items of income and expenses are treated as belonging to the owner.

In recent years, other hybrid entities such as limited liability partnerships, or limited liability limited partnerships also have gained popularity.

There are no statutory audit requirements, but audits may be required by members, lenders, and others.

## BRANCHES

A foreign company may operate a branch, perhaps a simple sales office, in any state. The company would be subject to state laws and would have to be registered as a “foreign corporation” in most states, subject to the usual corporate laws and state and federal income taxes. As a branch operation, the liabilities of the branch are the responsibility of the corporate owner. While there are no statutory audit requirements, adequate accounting records should be maintained for tax and management purposes. Branches have become unpopular.

## JOINT VENTURES

A foreign company may form a joint venture with a company in the U.S. for a specific purpose for a particular length of time. The joint venture may be organized as a partnership, limited partnership, corporation, or LLC and will be taxed accordingly. A joint venture agreement should clearly describe the relationship between the parties and their respective responsibilities and should provide especially detailed provisions on the resolution of disputes.

## MERGERS AND ACQUISITIONS

A foreign company may want to conduct business in the U.S. by acquiring or merging with an existing business (the target). An acquisition typically is accomplished by: buying the target’s outstanding equity

securities for cash or by giving the acquiring company’s securities in exchange; by acquiring the target’s assets for or for the acquiring the company’s securities; or by merging the target with another company owned by the foreign investor. Many permutations are possible.

Some states have specific rules regulating mergers (take-overs). The use of stock (or other securities) in these transactions might require approval by the U.S. Securities Exchange Commission or state securities regulatory agencies.

Certain larger (defined in reference to sales, assets and value of voting stock) mergers and acquisitions (including the formation of joint ventures) are required to file “pre-merger” notifications and to observe waiting periods.

The Committee on Foreign Investment in the United States (CFIUS) has the power to review and possibly prohibit a merger or acquisition if the transaction might pose a threat to U.S. national security. It is possible to notify the CFIUS of the planned transaction so that a 90 day period runs for CFIUS to review the transaction during which CFIUS must approve or prohibit the transaction. If CFIUS fails to do so within the 90 days; the transaction is deemed approved.

Before beginning any acquisition or merger negotiations or transactions, you should seek in-depth legal and accounting advice.

## ACCOUNTING AND AUDITING

Certified public accountants (CPAs) in the United States are licensed and regulated by each state (this is true for all professions). The American Institute of Certified Public Accountants (AICPA), the national organization of CPAs, prepares and grades the national uniform CPA examination on behalf of the states and acts on matters of national importance for the accounting profession.

U.S. accounting principles “consist of financial accounting and reporting assumptions, standards, and practices that a business firm must use in preparing external financial statements.”

Accounting principles in the U.S. are composed of official pronouncements of the Financial Accounting Standards Board (FASB) and other sources (including the Securities Exchange Commission for publicly-held entities under its jurisdiction) which together comprise generally accepted accounting principles. FASB is an entity supported by the private sector and is not financed, regulated, or dominated by any government.

U.S. accounting principles differ in various respects from international accounting principles promulgated by the International Accounting Standards Board (IASB).

Auditing Standards in the U.S. are established by the Auditing Standards Board of the AICPA. They differ in some respects from the International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants.

The Sarbanes-Oxley Act has established the Public Company Accounting Oversight Board which in the future will take a much more active role in the supervision of accounting and auditing procedures and in the promulgation of accounting standards in the United States.

Audit requirements for specific types of entities are discussed under the captions for those organizations.

**See special “check the box” rules in the tax section, which discuss how to treat a legal entity to be “taxed” as elected, despite its legal formation.**





## TAXATION

### GENERAL STRUCTURE

Taxation in the United States is complex and ever- changing. The federal government levies the following taxes: income (broadly defined and including capital gains) of individuals, corporations, trusts, and estates (partnership income is taxed to the partners); estate (death); gift; payroll, such as social security, payable by both employer and employee, and unemployment insurance; excise taxes on tires, gasoline, communication services, weapons, lubricating oils, aircraft, trucks, aviation fuel, and air travel tickets; tariffs and customs duties; stamp taxes on alcoholic beverages, cigarettes, and the gambling industry. The rates of any of these taxes and the methods used to calculate them can change at any time.

Taxes imposed by states and local governments vary widely, but usually consist of income, payroll, property, sales and use, inheritance, severance, gross receipts, and transaction taxes. These state and local taxes can be significant. Moreover, these taxes can apply even if the entity is exempt from federal income tax because of treaty protection. The effects of state and local taxes should be considered when any transaction is contemplated.

Congress legislates the federal tax law. The Internal Revenue Service (IRS), a branch of the U.S. Treasury Department, administers the law. This administrative function includes issuing rulings and regulations to clarify the law, developing and processing tax forms, auditing tax returns, and collecting delinquent taxes. The courts rule on tax

issues when there are litigated disputes between the government and taxpayers.

This booklet generally discusses taxation in the United States. In-depth professional advice should be obtained before business is transacted. US tax reform passed on December 20, 2018, known as the Tax Cuts and Jobs Act (or TCJA).

### INCOME TAXATION

#### General Principles

Taxation in the U.S. has generally adopted those criteria Adam Smith identified as his “canons of taxation.” His canons were:

**Equality.** Equality means paying taxes in proportion to income (ability to pay). U.S. taxes are generally progressive.

**Convenience.** Tax should be easily assessed and collected and administrative costs kept low. Self- assessment and filing of returns by taxpayers on a “pay-as-you-go” method in the U.S. have been convenient.

**Certainty.** Taxpayers should be able to predict “what, how, when” taxes are imposed. The U.S. previously scored high on this canon, but has not scored as high in recent years because massive changes in tax law have been adopted almost every year.

**Economy.** Only nominal costs by the government to collect taxes should be necessary and small costs for taxpayers to comply. The government’s costs to collect income taxes have been tolerable, but new complexities are imposing substantial costs for taxpayers to comply with the U.S. income tax law.

#### Reporting Periods

Individuals (including sole proprietorships) usually report income on the calendar year. Corporations may generally use a fiscal year that closes at the end of any month. Partnerships and limited liability companies generally must adopt the tax year of their partners since partnership income “flows through” to the partners upon whom it is taxed. Corporations that elect “S” status (which has the effect of being taxed as a partnership) generally must use a calendar year. A fiscal year normally is chosen the first time a tax return is filed.

#### Overview of Income

The Internal Revenue Code (“the Code”) defines taxable income as “all income from whatever source derived.” This definition was devised to tax all revenue from whatever source, and wherever earned - of U.S. citizens, U.S. residents, and U.S. corporations. After that ample inclusion, the Code then excludes from taxation such income as: life insurance proceeds; welfare and veterans’ benefits; gifts; meals and lodging (for employer’s convenience); damages for personal physical injury; some disability payments; other similar items. Corporate income is taxed at the corporate level and is taxed again when dividends are received by the shareholder.

#### Overview of Deductions

For business returns of corporations, proprietorships, and partnerships (limited liability companies usually report as partnerships), deductions consist of: the cost of goods sold, depreciation,

interest, bad debts, repairs and maintenance, travel, taxes (except federal income taxes), advertising, salaries and wages, retirement plan contributions, business gifts (not over \$25 per person per year), business meals and entertainment (only 50 percent), professional fees, charitable contributions (limited for corporations), and any other “ordinary and necessary business expenses.”

Individuals may deduct medical expenses (with limitations), interest paid on a personal residence mortgage (with limitations), interest paid to carry investments (with limitations), property taxes (with limitations), state and local income taxes (with limitations), or state and local sales and use taxes, charitable contributions (“all” with limitations).

Both businesses and individuals may deduct, with some limitations, losses that result from transactions entered into for a profit. Examples include losses incurred in the sale of business real estate or capital stock.

#### Alternative Minimum Tax

This tax ensures that individuals and corporations pay a “minimum tax” by aggregating and taxing some items that receive preferential tax treatment under the tax law. For years after 2018, AMT has been repealed for corporations.

#### Form versus Substance

In tax planning for a U.S. operation, the form versus substance concept must be considered. Many non-U.S. tax jurisdictions rely heavily on just the paper form of the transaction.

The U.S. tax authorities have the power to overturn the form of the transaction to the detriment of the taxpayer, even though the form of the transaction is structured properly, if the underlying forces, the “substance” of the transaction, warrant a different tax treatment.

## INDIVIDUAL TAXATION

The general matters regarding income and deductions previously discussed are sufficient for a brief review of individual taxation.

### Rates

The individual federal income tax rates for tax year 2020 are as follows:

RATE	FOR UNMARRIED INDIVIDUALS, TAXABLE INCOME OVER	FOR MARRIED INDIVIDUALS FILLING JOINT RETURNS, TAXABLE INCOME OVER	FOR HEADS OF HOUSEHOLDS, TAXABLE INCOME OVER
10%	\$0	\$0	\$0
12%	\$9,875	\$19,750	\$14,100
22%	\$40,125	\$80,250	\$53,700
24%	\$85,525	\$171,050	\$85,500
32%	\$163,300	\$326,600	\$163,300
35%	\$207,350	\$414,700	\$207,350
37%	\$518,400	\$622,050	\$518,400

### Capital Gains

Beginning May 6, 2003, net long-term capital gains (the excess of net long-term capital gains over net short-term capital losses) of individuals are taxed at a maximum rate of 15 percent (except for gains from art and certain depreciable real estate). Net capital losses may be used to offset ordinary income up to \$3,000 per year. Losses in excess of \$3,000 can be

carried forward. Long-term capital gains are gains earned on the sale of capital assets which were held for more than one year. There is a 3.8% additional tax on passive capital gains.

### Dividends

For individual taxpayers the top rate on most standard domestic dividends is 20 percent, subject to complex limitations. A 3.8% surtax may also apply.

### Due Dates

Individual income tax returns are generally due April 15 for calendar year taxpayers or the 15th day of the fourth month following the close of a fiscal year; extensions up to six months can be obtained. Estimated taxes must be paid in quarterly installments during the year unless all taxes due are withheld from employment earnings.

### Children

In 2018, the unearned income over \$2,100 (principally interest, rents, royalties, annuities, capital gains, and dividends) of children under age 18 is taxed at the parents' rate determined as if the income were the parents' income.

## CORPORATE TAXATION

### General

For tax years beginning in 2018, the TCJA establishes a flat 21% corporate rate, which also applies to personal service corporations (PSCs).

“C” corporations are subject to “double taxation” in that the entity itself is taxed at the corporate level, and

after-tax profits are subject to tax when distributed to shareholders thereafter.

“S” corporations are taxed only at the shareholder level (which is equivalent to partnership/flow-through taxation).

The cash method of accounting is denied for many corporations (companies with less than \$25 million in sales may be exempted from this rule).

Corporations cannot deduct net capital losses against non-capital income; however they can carry them forward.

Generally, for net operating losses (NOLs) arising in tax years ending after 2017, a corporation must carry the loss forward to future years. The corporation may carry the losses forward indefinitely.

70 percent to 100 percent of dividends received by “C” corporations can be non-taxable.

Corporate tax returns are due the 15th day of the third month following the close of the corporation's fiscal year (extensions up to six months available).

Corporations are required to pay quarterly payments of their estimated taxes for each fiscal year; those with taxable income of \$1 million or more must pay 100 percent of the current year's tax to avoid penalties; smaller corporations can base their estimated taxes on 100 percent of the prior year's tax.

An interest charge domestic international sales corporation (IC-DISC) can defer a set percentage of taxable income attributable to \$10 million or less of qualified exports with the corporate shareholders paying an interest charge on the deferred tax.

U.S. Partnerships and LLCs may elect, if eligible, to be taxed as a corporation for federal tax purposes.

Certain corporations under common control can elect to combine their income and losses by filing consolidated returns for purposes of applying graduated income tax rates.

**Rates**

For tax years beginning in 2018, the TCJA establishes a flat 21% corporate rate, which also applies to personal service corporations (PSCs).

**GENERAL ASPECTS OF INTERNATIONAL TAXATION**

The tax laws of the United States as they pertain to the taxation of foreigners are many and complex.

Comprehensive explanations of them would require many pages. The following material is a brief overview.

Foreign individuals and corporations are generally subject to these U.S. taxes:

1) nonresident aliens and foreign corporations are taxed at graduated rates (see discussion above) on taxable income “effectively connected” (ECI) with a U.S. trade or business. A nonresident alien or foreign corporation that is a member of a partnership (domestic or foreign), is deemed engaged in any U.S. trade or business carried on by the partnership. The principal effect is that a foreign partner’s distributive share of a partnership’s effectively connected income (or income attributable to a permanent establishment) is subject to income tax in the partner’s hands (and thus taxed at the corresponding individual or corporate tax rate). A partnership also might be subject to the U.S. branch profits tax of 30 percent on income not deemed to be retained in the U.S. operation

2) A flat 30 percent tax rate applies to US source investment, fixed or determinable

annual or periodic (“FDAP”) income not effectively connected with a U.S. trade or business; these include dividends, rents, premiums, annuities, royalties from timber, coal and iron ore, and gains from the sale of patents, copyrights, etc., if payments are made on future productivity. This withholding rate may be reduced or eliminated if a tax treaty applies.

3) Regular income tax rates (individual or corporate) on the net gain from the sale of U.S. real property under the Foreign Investment in Real Property Tax Act (“FIRPTA”). Included as real estate are direct ownership of real property and perhaps related personal property, interests in natural resources and leaseholds, and equity interests in a U.S. corporation if 50 percent of the value of its assets (excluding some liquid assets) consists of U.S. real property interests. The tax on the sale of real property is collected through the buyer’s withholding ten percent of the gross purchase price unless the Internal Revenue Service agrees to a lesser rate to reflect a lesser actual tax on the gain.

4) Estate and gift taxes (rates range from 18 to 45 percent) on all worldwide property owned by resident individuals and estate taxes on U.S.-situs tangible and intangible property owned by foreigners not resident in the United States. Tangible U.S.-situs property owned by non-resident foreigners is subject to gift taxes. Tangible property includes real estate and personal property. Intangible property includes stock issued by a corporation organized under U.S. law and debt obligations of the U.S., other political

units of the U.S., or of a U.S. partnership, corporation, estate, trust, citizen or resident of the United States.

The United States has income tax treaties with many countries and regions.

Even if the income tax treaty exempts the entity from federal income tax, the entity may still be subject to state taxes including, but not limited to, income, gross receipts, sales tax, etc.

**FOREIGN INDIVIDUALS RESIDING IN THE U.S.**

Objective standards of immigration status and the number of days a person is physically present in the U.S. are the preeminent determinants as to whether a foreign national will be considered a resident of the U.S. and subject to U.S. tax on his worldwide income. An alien individual is treated as a resident of the United States for any calendar year if the individual is a lawful permanent resident (“green card holder”) of the United States at any time during the calendar year, or the individual meets the substantial presence test. An individual meets the substantial presence test with respect to any calendar year if:

- the individual was present in the United States at least 31 days during the calendar year, and
- the sum of the number of days on which the individual was present in the U.S. during the current year and the two preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days.

IN THE CASE OF DAYS IN:	THE APPLICABLE MULTIPLIER IS:
Current year	1
1st preceding year	1/3
2nd preceding year	1/6

For example, a foreign national who was in the United States for:

120 days in 2007 x 1	= 120
120 days in 2006 x 1/3	= 40
120 days in 2005 x 1/6	= 20
<b>TOTAL</b>	<b>180</b>

would not be considered to have had a substantial presence in the U.S.

There are exceptions to this rule and certain events that occur before or after substantial presence can escape U.S. taxes. One significant exception to the substantial presence test is for individuals who have a tax home in another country or a closer connection to a foreign country. IRS form 8840, “Statement of Closer Connection Exception,” can be used to document the claim for a closer connection. Each situation should be studied carefully.

Nonresident aliens temporarily working in the U.S. as employees of their nonresident foreign employer may be exempt from U.S. tax if they are in the U.S. not more than 90 days, their gross income is not more than \$3,000 yearly, and their employer is not engaged in trade or business in the United States. Tax treaties may also affect these individuals.

Nonresident aliens are subject to U.S. social security taxes (see the “Other Taxes” section in this booklet) on income from services provided in the United States.

Totalization agreements provide exceptions to eliminate dual social security coverage and taxation when a person from one country works in another and is required to pay such taxes to both countries on the same earnings. The U.S. has totalization agreements in effect with Australia, Austria, Belgium, Canada, Czech Republic, Chile, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea (South), Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

Nonresident aliens subject to U.S. income tax on wages and salaries pay at the normal graduated rates on their income as either single individuals or as married filing separately. Income taxes are withheld from salaries and wages by their employer. Deductions are limited to business expenses and can be taken only against effectively connected income (income connected to a U.S. business), contributions to U.S. charities, and casualty losses on U.S. property. Most are allowed one personal exemption, although residents from some countries can claim more than one.

## FOREIGN BUSINESSES IN THE U.S.

### Exporting into the U.S

**Example 1:** A Canadian Company, “C,” manufactures its products in Toronto. Based on market research, the company believes it could successfully sell its products to

U.S. customers. C advertises in U.S. trade journals from its office in Toronto and begins to receive requests for orders from U.S. companies. The Canadian company ships its goods from Toronto, issues its invoices from Canada, and receives payments in the mail from its U.S. customers without having an employee in the United States.

It seems clear that the Canadian company is not engaged in trade or business in the United States. Consequently, the profits it makes from selling its products to U.S. consumers are not subject to U.S. income tax.

The U.S. looks to all the facts and circumstances to determine whether the foreign company has engaged in trade or business in the United States. For the U.S. government, it is an all or nothing proposition. If it is unsuccessful, no tax is collected; if it is successful, the potential for significant revenue exists.

The United States has entered into a series of tax treaties with foreign countries that, in effect, seek to encourage a greater amount of commerce with those countries without income tax getting in the way. A tax treaty allows a foreign corporation resident in a foreign country with which the U.S. has a tax treaty to conduct more activities in the United States without being subject to U.S. tax as long as it does not create a “permanent establishment” in the United States. In many cases, this allows the foreign company to engage in trade or business in the United States and, as long as it is not through a permanent establishment, avoid U.S. tax.

States are not bound by federal tax treaties. If the activity of a foreign individual or company rises to the level of “doing business” under state law (i.e. creates “nexus”), such individual or company may be subject to tax. Further, physical presence in a state is not required to create nexus. Careful review of each state’s nexus rules will determine a company’s taxability in a state.

### Foreign Corporation Representatives in the United States

When a foreign corporation begins to have personnel representing it physically in the United States, it is highly likely to be considered as engaging in trade or business. However, there are two different types of representatives, resulting in two different outcomes to the permanent establishment determination.

#### Independent Agents

An independent agent is a person who works for himself in an independent contractor capacity when engaging in activities on behalf of a foreign corporation in the United States.

**Example 2:** An Italian company, “I,” retains a Denver-based distributor, D, to handle I’s products on a consignment basis. D, an independent distributor, does not take title to the products. D uses its best efforts to see that customers located by I receive proper delivery of the products. D does not advertise or solicit sales, has no capabilities to repair the product, and must consult I when one of its customers is dissatisfied and seeks a replacement product.

Based on these facts, the foreign corporation is not considered engaged in trade or business in the United States.

Most states will consider I exempt from state taxation. However, some states may attempt to attribute D’s activities conducted on I’s behalf to I and attempt to require I to comply with the state’s taxes. Because of the constantly changing state and local tax schemes various states have enacted, Company I should consult with a state and local tax professional to determine if it is subject to tax in any state and local jurisdictions.

#### Dependent Agents

The more difficult situation is the so-called dependent agent who is under the control of the foreign corporation in terms of its activities in the United States.

**Example 3:** A Korean corporation, “K,” sends sales representatives from Seoul to the United States. These representatives bring with them a supply of inventory and have complete authority to bind K on sales contracts.

In this situation, K itself can be considered as doing business in the United States because of the control it maintains over its own employees. Indeed, the very fact that they are employees can raise the issue of K’s being subject to U.S. tax at this early stage. Even if they were not employees, but had the same authority, K could still be subject to U.S. tax.

Tax treaties play an important role in this matter. A standard provision of most tax treaties deals with the subject of when

the presence of an independent agent or a dependent agent will constitute a permanent establishment. Remember, a tax treaty gives the foreign corporation additional protection by saying it may engage in business in the United States as long as the business is not conducted through a permanent establishment.

Article 5 of the U.S. Model Income Tax Treaty defines a permanent establishment as “a fixed place of business through which the business of an enterprise is wholly or partly carried on” including especially a place of management; a branch; an office; a factory; a workshop; and a mine, oil or gas well, quarry, or any other place of extraction of natural resources.

This definition gives an independent agent wide latitude to conduct activities without forming a permanent establishment of the foreign corporation. On the other hand, a dependent agent (and these are the terms used in tax treaties) has to be certain that he does not “have and habitually exercise” the authority of the corporation.

Even if K is exempt because a treaty protects it, treaty protection does not extend to state taxation. States would consider the sales representative’s physical presence in the state sufficient to create nexus, or a filing obligation, in the states. As a result, K would be required to collect the state’s sales tax. Moreover, K would be required to comply with the state’s gross receipts tax, if the state has one, and possibly its income tax. Because of the wide range of state and local taxes that K may be subject to and exemptions that could apply,

K should consult with a state and local tax professional to ensure it is complying with all applicable state and local taxes.

#### Inventory in the United States

**Example 4:** An Australian company, A, has customers in the United States who are complaining that it takes too long to fill their orders for A’s products. To solve this problem, A should have inventory in the United States.

For federal taxes, just having inventory physically located in the United States does not automatically result in the foreign corporation being treated as doing business or having a permanent establishment in the U.S. if the foreign corporation does nothing more in the United States. However, if a company like A has, in addition to the inventory, dependent agents who are soliciting and consummating sales in the U.S., it will have crossed the line and be exposed to U.S. tax.

For state tax purposes, having inventory in the state creates a physical presence and nexus for Company A in states where inventory is located. Many states income tax base begins with federal taxable income and, since A does not file a federal tax return, A would be exempt from state income tax. However, some states, for example New York, would require A to prepare its state income tax return as though it was not exempt from federal income tax. Moreover, A would be required to collect and remit sales tax and pay personal property taxes in states where inventory was located. As always, A should consult with a state and local tax

professional to ensure it is complying with all applicable state and local taxes.

#### Technology Transfers to the United States

**Example 5:** A Swiss corporation, “S,” has developed sophisticated technology in the manufacture of food products. S could have avoided U.S. tax by having only independent agents in the U.S. and exporting its products from Switzerland. However, S realizes that customs duties were too high.

Three scenarios arise from the fact pattern in Example 5.

1. If S sets up its own manufacturing plant in the U.S. (and uses its technology in the U.S.), it will be considered engaged in a trade or business in the U.S. and will be subject to U.S. tax, including federal, state and local filing obligations.
2. If S enters into a licensing agreement with a U.S. manufacturer under which S transfers to the U.S. manufacturer the right to make its products under license and other intangible property rights, S will not be considered to be engaged in a trade or business in the U.S. and is not subject to U.S. tax. Some states may attempt to tax S under an economic nexus theory. Under this theory, by licensing its technology to the U.S. manufacturer, S is pursuing the state’s customers and would have a filing obligation. Because this is a developing area of the law, the laws vary by state, and exemptions may apply, S should consult with a state and local tax professional to ensure it is complying with all applicable state and local taxes.

3. If S allows the manufacturer to have the right to use that technology, it may put restrictions on the U.S. Company so that it cannot transfer the technology to others; S retains ownership of the intangible assets (such as a U.S. patent).

As in situation 2, under situation 3, S is not engaged in business in the U.S. and is not subject to U.S. tax.

However, S will want to receive royalty income (the form of compensation that often results from these types of licensing agreements) from the independent manufacturer. Royalties paid by the U.S. manufacturer to S for the use of technology in the U.S. is considered “FDAP” income subject to U.S. withholding tax. As a result, S would have an initial exposure to U.S. tax in that form. However, the U.S. has a tax treaty with Switzerland, which, in effect, says that such royalties are exempt from withholding. As a result, S can achieve its objective by having its products made in the U.S. (and therefore avoiding the substantial customs duties that would result if it exported its products from Switzerland) without incurring significant U.S. tax on the royalty income.

As with situation 2, some states may attempt to tax S under an economic nexus theory. Under this theory, by licensing its technology to the U.S. manufacturer, S is pursuing the state’s customers and would have a filing obligation. Because this is a developing area of the law and exemptions may apply, S should consult with a state and local tax professional to ensure it is complying with all applicable state and local taxes.

### Contract Manufacturing

**Example 6:** A Belgian company, “B,” would like to manufacture in the U.S., but it does not want to license a U.S. party (perhaps because B has very significant marketing acumen, but may not hold a patent or other kind of intangible asset that could be licensed).

However, B’s U.S. customers have complained about delays in availability of inventory and B has realized that customs duties and other factors will not enable it to service the U.S. market by exporting from Belgium. In this situation, contract manufacturing can be an interesting alternative from commercial and tax viewpoints.

A contract manufacturer would be a party in the United States with manufacturing facilities, willing to make the products to B’s specifications. This type of activity often involves manufacturing non-sophisticated products, but marketing them extensively in a sophisticated manner. The marketing aspect would then be the element that would add value to the product for the U.S. market (as opposed to the manufacturing itself).

As a party unrelated to B, the U.S. contract manufacturer would be dealing at arm’s length automatically. Therefore, the question is to what extent the U.S. contract manufacturer/foreign company arrangement results in B’s doing business in the United States? If B does not have its employees in the U.S. (or only for a very short period of time), it would seem that it is not engaged in trade or business in the United States.

In a more complex situation, B operates with the U.S. contractor on a “take or pay” contract, i.e., the contract manufacturer produces the products to B’s specifications and B must either take that inventory or pay for it. In such a situation, once this property is produced, it comes under B’s ownership. Now B has inventory in the U.S. from which it is making sales. It might be that even in a situation like this, B would not be subject to U.S. tax, since Article 5 of the U.S.-Belgium Tax Treaty defines a permanent establishment as not merely having inventory in the United States.

Even if B is exempt because a treaty protects it, treaty protection does not extend to state taxation. States consider inventory a physical presence in the state sufficient to create nexus, or a filing obligation, in the states. As a result, B would be required to collect the state’s sales tax. Moreover, B would be required to comply with the state’s gross receipts tax and/or income tax. Because of the wide range of state and local taxes that B may be subject to and exemptions that could apply, B should consult with a state and local tax professional to ensure it is complying with all applicable state and local taxes.

### Permanent Establishment in the United States

**Example 7:** A German corporation, “G,” establishes a permanent enterprise in the U.S.; G is now considered a U.S. taxpayer and will be required to report income that is effectively connected with its U.S. trade or business and pay the appropriate income tax.

When a foreign company is directly involved in a business in the U.S., it is necessary to separate the income and expenses attributable to the U.S. operations from those that are not. This often produces commercial difficulties, since the way a company measures income and expenses from a business standpoint often does not compare with the way it has to measure income and expenses for tax purposes. For example, G probably treats its U.S. branch operations as if they were a separate company. The U.S., however, views G as the taxpayer. Consequently, it needs to have information not only with regard to what is going on in the U.S., but also as to what is happening outside the United States. In addition, a branch level tax of 30 percent (can be eliminated or taxed at a different rate by treaty) is charged to corporations on income effectively connected with a U.S. branch that is not deemed to be retained in the business.

G can avoid this problem by forming a separate subsidiary. G can form (1) a U.S. subsidiary, (2) a German subsidiary, or (3) a foreign subsidiary that is not incorporated in Germany.

1. U.S. subsidiary. Such a subsidiary would have to report its income and deductions and pay the proper tax, but G, the German parent, would not be required to report its income. If the parent and subsidiary deal with each other on an arm’s-length basis, the foreign parent’s income would not be subject to U.S. tax, while the U.S. subsidiary’s income would be. Most foreign companies prefer this arrangement.

2. Foreign subsidiary incorporated in parent’s country. The objective of creating another company would be to insulate the foreign parent’s income from direct U.S. taxation. If G creates a German subsidiary whose only activity would be the operation conducted in the U.S., the initial objective would be to avoid paying the U.S. withholding tax that would be due on dividends paid from the U.S. subsidiary to G. While the U.S. tax law contains a U.S. branch tax on dividend equivalents from a U.S. branch to its head office outside the U.S., Germany is one of the countries with a tax treaty with the U.S. which avoids the U.S. branch tax.
3. Other foreign non-U.S. subsidiary. If G establishes a subsidiary in some other foreign country, it will be for German tax purposes, not U.S. tax purposes. For example, if G established a subsidiary in a country that does not subject the income from U.S. operations to as high a tax rate as Germany, it would save the difference between the German tax and that foreign country’s tax.

### Double Taxation Relief

Most foreign countries provide some kind of relief in their tax law to avoid double taxation when a company created in their country does business outside the country. This may be accomplished in many ways, including the two most common methods.

1) The foreign country exempts earnings generated outside its country from taxation. If this is the case, the foreign company will want to keep its U.S. tax to a minimum since there is no benefit under its own system for taxes incurred in the United States.

2) The foreign country provides a tax credit for taxes paid to the United States. When the home country's tax rate is as high, or higher than the U.S. tax rate, incurring a U.S. tax may not be significant.

Tax treaties need to be considered in this regard. Some tax treaties have specific double tax provisions. These rules provide relief from double taxation over and above what is contained in the internal tax laws of the home country.

#### Investments Taxed at Flat 30 Percent

**Example 8a:** If a Togo Corporation, "T," buys shares in a U.S. company which is the distributor of its products and receives dividend income from those shares, the U.S. company will have to withhold at the flat rate of 30 percent on those dividends.

**Example 8b:** If T wants to help its customers in the United States and provides financing on which it receives interest income from U.S. customers, the income will be subject to the 30 percent withholding tax.

**Example 8c:** Aware of its U.S. customers' weak financial condition, T decides to invest in the customers to help them overcome difficult times. The investment takes the form of a purchase of shares on which dividends are not paid. However, the investment appreciates in value. After three years, T either sells the customers' shares or

the customers redeem the shares for cash. T would not be considered engaged in trade or business in the United States. In addition, the capital gains it realizes on the sale or redemption of the shares is not considered income for U.S. tax purposes.

**Example 9:** A Brazilian company, "B," wants to benefit from the lower inflation and foreign exchange relief arising from investing in securities that have not been denominated in Brazil's currency. If B buys the usual form of debt by putting money with companies in the United States, it will be subject to U.S. withholding tax of 30 percent on the interest income it receives.

However, if B invests in portfolio debt or puts money on deposit with U.S. banks, a special exception enables B to receive "FDAP" income in the form of interest without being subject to U.S. tax.

#### Tax Treaties and Investments

For companies seeking to invest in the United States, the benefits conveyed by tax treaties should not be overlooked. These treaties have special rates of withholding tax (including zero percent) that apply to dividends, interest, rentals, and royalties paid by a U.S. party to a foreign corporation. Examples: (1) A corporation resident in the United Kingdom can receive interest income exempt from the 30 percent U.S. withholding tax. (2) A Netherlands corporation will be subject to only a 15 percent withholding tax on dividend income (as opposed to the 30 percent rate) from an investment in an U.S. corporation's shares.

To ensure that the foreign company is entitled to claim the benefits of a tax treaty, it must be established that the foreign corporation is actually resident in the country with which the United States has signed a tax treaty. There can also be additional requirements in order to satisfy tax treaty provisions designed to prevent abuse.

## GENERAL GOVERNMENT REPORTING FOR FOREIGN INTERESTS

### Form 5472

U.S. corporations that are controlled (25 percent of voting or value of stock) by foreign "persons" and all foreign corporations engaged in a trade or business within the U.S. annually must file form 5472, an informational form in which transactions with related foreign "persons" are reported. For the purposes of this reporting, "persons" include: individuals who are not citizens or residents of the U.S.; partnerships, associations, companies, and corporations not created under the laws of the U.S. or any state; foreign trusts; foreign estates; and foreign governments or agencies. There are very few exceptions from filing this form, the most significant of which is the exception from filing if the corporation has no reportable transactions of the types listed in Parts IV and V of the form. Other exceptions require careful study of the particular circumstances involved. This form should be filed (1) with the corporation's U.S. income tax return with the proper Internal Revenue Service Center and (2) with the Internal Revenue Service Center in Ogden, Utah.

### Form 5471

U.S. citizens and residents and U.S. corporations, partnerships, estates, and trusts who are officers, directors, or shareholders in certain foreign corporations, annually must file form 5471, an informational form, with respect to each foreign corporation with which they are involved. There are four categories of filers, each of which must be carefully noted by any person or entity that is a prospective filer. This form should be filed with the reporting person's income tax return with the proper Internal Revenue Service Center.

Substantial penalties may be imposed for failing to file these information reports or for failing to maintain the proper books and records.

Other foreign reporting obligations include FinCen114 (Foreign Bank and Financial Accounts), Form 8938 (Statement of Specified Foreign Financial Assets), and Form 926 (US Transfers of Property to a Foreign Corporation).

### Other Major Reporting Requirements

The U.S. government also has enacted reporting requirements under the International Investment and Trade in Services Survey Act of 1976 ("IITSSA") and the Agricultural Foreign Investment Disclosure Act of 1978 ("AFIDA").

IITSSA requires reports to the U.S. Department of Commerce about investments in U.S. business enterprises (incorporated or unincorporated) when a foreign person owns or controls a ten percent or more interest.

The reports involved are initial investment reports, quarterly update reports, annual update reports, and quinquennial reports. IITSSA also requires the U.S. Department of the Treasury to obtain data about foreign portfolio investments in the United States. These reports are filed every five years. Finally, IITSSA requires reporting regarding foreign exchange transactions, credit transfers, and the export of U.S. currency.

AFIDA requires foreign persons to make reports about the acquisition or transfer of agricultural land (farming, ranching, forestry and timber lands) within 90 days after the transaction.

Additionally, Treasury Department Form 90-22.1 must be filed for every year a foreign bank account is owned by a U.S. citizen or resident; there is a \$10,000 penalty for noncompliance.

## OTHER TAXES

As mentioned previously, federal, state, and local governments raise revenue through a variety of taxes. The more important are:

### Social Security Tax

The 2018 tax rate on both the employer and the employee is 7.65 percent each that includes a retirement and disability component of 6.2 percent and a Medicare Hospital Insurance component of 1.45 percent. Wages up to \$132,900 are subject to 6.2 percent; all wages are subject to the 1.45 Medicare Hospital Insurance component. For the self-employed, the tax rate is at 15.3 percent comprised of 12.4 percent

for retirement and disability coverage (maximum taxable self-employment net income is \$102,000) and 2.9 percent for Medicare on all self-employment net income.

### Federal Unemployment Tax

The 2018 wage base for unemployment tax is \$7,000, and the rate through is 6 percent, subject to a maximum 5.4 percent state credit on the first \$7,000 of wages.

### Sales Tax

There are no federal value-added or sales taxes. Sales taxes are collected on the sales of a wide range of goods and services in many state and local governmental areas. Physical presence is no longer required in order for a company to be subject to state sales/income tax. States are aggressively pursuing an economic nexus theory under which merely pursuing a state's market by selling to customers in the state creates nexus. Businesses need to be mindful of any activity conducted in each of the US states.

### Local Income

Most, but not all, states impose income taxes on individuals and corporations. Some cities and other local governments assess income taxes on corporations and individuals that are calculated in a variety of fashions. Some impose a flat tax on businesses and/or workers.

Physical presence is no longer required in order for a company to be subject to state sales/income tax. States are aggressively pursuing an economic nexus theory under which merely pursuing a state's market by selling to customers in the state creates nexus.

Businesses need to be mindful of any activity conducted in each of the US states. In addition, Public Law 86-272 provides a limited federal exemption from net income taxes for businesses selling tangible personal property subject to many restrictions in activities conducted by sales representatives.

### Property Tax

Many state and local jurisdictions levy taxes on tangible personal property. For a business, tangible personal property may include product inventories, equipment, office furniture, supplies, etc. Many local jurisdictions levy taxes on real estate property.

### Inheritance Tax

Some states tax inheritances based on the fair market values of the property received by heirs. These taxes are generally creditable toward the federal estate tax.

### Other Corporate Level Tax

In response to the exemption provided by Public Law 86-272, a growing number of states have enacted taxes based on something other than net income, such as capital, gross receipts, or modified gross receipts. Moreover, many of these taxes consider only require the business to have economic nexus with the jurisdiction before having a filing obligation.



## END NOTES

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10. A complete list of state offices that promote investment in the various states is available from any U.S. member of HLB International.
11. From Carol Hildebrand, an attorney practicing immigration law for individuals and multinational corporate clients with Sherman & Howard L.L.C., a major law firm in Denver, Colorado. Ms. Hildebrand is a past chairperson of Colorado's chapter of the American Immigration Lawyers Association and The Colorado Bar Association's International Law Committee. She can be reached at 633 17th Street, Suite 3000, Denver, CO 80202.
12. Lanny G. Chasteen, Richard E. Flaherty, and Melvin C. O'Connor, Intermediate Accounting (New York: Random House Business Division, 1987).
13. Adam Smith's Wealth of Nations, Book V, Chapter II, Part III.
14. Condensed and updated, with permission, from an article by Walter O'Connor, PhD, CPA, published in the "Tax Adviser," January, 1990. Dr. O'Connor is the director of the Masters in Taxation program at Fordham University's Graduate School of Business in New York City and is Editor-in-Chief of The International Tax Journal.

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