A Foreign Investor's Guide to
Doing Business in the United States

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Contents

Introduction
This paper is intended as a brief guide and overview to the U.S. financial and tax system for foreign business people who intend to enter the U.S. market whether to sell to customers, establish a distribution company, invest in property, purchase an existing business, or engage in some other business activity.

By necessity, this information is succinct and general. Specific questions and issues may result in answers that vary with some of the conclusions herein.

Business Entities
In the United States, there are various business forms that the law recognizes. There are sole proprietorships, general and limited partnerships, limited liability companies, corporations and joint ventures. The forms of business that are often utilized by foreign investors are corporations and limited liability companies.

There are a number of factors to consider when deciding the appropriate form of business venture to enter. These factors include difficulties in initial organization, capital and credit requirements, management and control, profit and loss considerations, liability, transferability of ownership, continuity of existence and tax treatment.

Corporations are the most common form used by businesses because of the ease of:

- Establishing or dissolving a corporation
- Transferring ownership, and
- Limiting liability to the amounts invested, unlike in certain foreign countries where corporate obligations are the responsibility of owners.

Foreign investors will find that it is quite easy to incorporate in the United States. State law controls the guidelines and restrictions for incorporation and Delaware and New York are popular among foreign investors due to their flexible laws regarding the formation and operation of corporations. Almost 40 percent of the corporations listed on the New York Stock Exchange are incorporated in one of those two states, regardless of where their headquarters are. Such corporations simply “qualify to do business” in the other states where they operate. Corporations raise capital through the issuance of stock and debt financing; the latter certainly has become very popular in recent years.

Corporations must have certain levels of capital and follow some formalities in operating, such as holding regular meetings of shareholders and directors.

Partnerships are associations of two or more persons or entities formed to carry on a business for profit or to own investments. Capital is raised by investment of the partners. Liability under a partnership depends on the type of partnership that is created. Under a general partnership, each partner is liable for any and all incurred losses, whereas in a limited partnership, a limited partner generally has no say in the day-to-day operations of the business and is liable only to the extent of his investment.

Limited Liability Companies (LLC) allow for limited liability of owners. That is, the personal liability of owners for the LLC's debts and obligations is limited to their investment, similar to corporations. At the same time, an LLC can be treated like a partnership for income tax purposes at the election of its owners. Taxation as a partnership generally means that the LLC is not taxed and that items of income, deduction and credit “pass through” to the owners from the LLC as if it were a partnership.

Joint ventures can be corporations or partnerships and are usually formed when two or more persons want to carry out a particular venture. Joint ventures are mainly used in situations where risk and capital requirements are very high. A joint venture can be characterized by four elements -- an express or inferred agreement among the parties, joint contributions of property and services, a sharing of profits and losses and a mutual right of control.

Exchange controls and restrictions on foreign investment

In the United States, there are virtually no restrictions on exchange. However, if any transaction exceeds $10,000 in currency or equivalents, there is a requirement to complete certain federal disclosure forms.

Federal and state governments place restrictions on foreign investments in various industrial sectors. At the federal level, restrictions have been limited to a few areas, such as communications, maritime, mineral interests, energy, aviation and banking. The federal government derives its power to regulate foreign investment from the Commerce Clause of the U.S. Constitution. The Commerce Clause severely limits the powers of the individual states to place restrictions on foreign investment. However, certain states have some restrictions mainly pertaining to real property and natural resources.

Investment incentives

There are various reasons why foreign investors might choose the United States as a place of operation. One reason would be a need to diversify operations to a more stable political and economic climate than that of their own country. Another reason would be a desire to control the importing of their goods into the United States.

Other incentives to invest in the United States are the inexpensive labor force, the various climates that might be suitable to a particular business, the diverse population centers and the ever-changing trends and tastes in a very large and affluent consumer market.

Various jurisdictions provide incentives for locating a business, or building a plant, including:

- Reduced or eliminated real estate, income or other taxes
- Low-cost financing arrangements, and
- Foreign trade zones (imported goods are stored and become dutiable only upon shipment to the actual customer).

Labor relations and social framework

Labor relations in the United States are very positive with a well-trained, flexible labor force. Only about 10 percent of the labor force is unionized. In addition, there are no restrictive government laws or regulations on closing plants, dismissing employees, etc.; absent a union contract, employees can be dismissed with customary notices (not required by law), ranging from two weeks to several months.

The federal government's interest in the rights and obligations of employees and their employers resulted in the creation of agencies to implement certain laws and regulations such as

- The National Labor Relations Board's two principal functions are to prevent and remedy unfair labor practices by employers and labor organizations and to oversee the conduct of secret-ballot elections to determine whether employees desire union representation in collective bargaining.
- The Occupational Safety and Health Administration (OSHA) develops safety and health standards in the workplace. These standards were enacted to reduce the incidence of personal injuries, illness and death as a result of employment.
- The Social Security Program is designed to compensate workers during their retirement and to provide for widows (and widowers) and children under 18 when a family member is accidentally killed or disabled. The program also provides medical insurance for people over age 65.

At present, people under 65 have to obtain their own medical insurance, either privately or through their employers; a lengthy national debate on mandating the availability of medical insurance resulted in nationally available insurance for most other groups in the years to come.

The states provide unemployment benefits of up to $900 a week (varies greatly from state to state), for up to one year to people whose jobs are eliminated or who are dismissed. Localities provide aid to the poor, disabled or disadvantaged in the form of cash grants, subsidized or free housing, food stamps, etc.

U.S. immigration laws regulate persons and their activities while in this country. In order to work in the United States, all foreigners must have an appropriate “work” visa; working in the United States without such a visa, or engaging a person without the visa, can result in substantial fines for both the employer and the employee. Persons who are not otherwise exempt from visa requirements should apply to a U.S. consular office for a visa appropriate to the purpose for which entry is desired.

Statutory reporting requirements

Unlike many foreign countries, the United States does not require a statutory audit of all companies. However, the Securities and Exchange Commission (SEC) requires audited financial statement for all publicly-owned companies. Audited financial statements filed with the SEC generally must include:

- Balance sheets as of the end of each of the two most recent fiscal years
- Statements of income, stockholders’ equity and cash flows for each of the three most recent fiscal years
- Notes to financial statements, and
- Supplemental schedules in areas like investments, property and equipment and key operating expenses.

The Bureau of Economic Analysis of the Commerce Department requires a number of reports to be filed for all “foreign direct investments” in the United States; this is defined as the ownership or control, directly or indirectly, by one foreign person of as little as 10 percent of the voting securities of an incorporated U.S. business enterprise or rented real estate, or an equivalent interest in an unincorporated U.S. business enterprise, including a branch.

The reports required to be filed vary depending on size and include:

- Initial report of a foreign person’s direct or indirect establishment, acquisition, or purchase of the operating assets of a U.S. business enterprise, including a real property investment (Form BE-13)
- Quarterly report of all transactions with a foreign parent or affiliate for a U.S. affiliate (Form 605 or 606B)
- Annual survey of foreign direct investment in the United States (Form BE-15), and
- Quinquennial (every five years) benchmark survey of foreign direct investments in the United States (Form BE-12).

The tax system

Under the U.S. federal system, taxes are levied by the various levels of government (federal, state and local) based on various methods.

Income taxes

The United States, most states and certain localities tax the net income of corporations, individuals, estates and certain types of trusts. Generally, net income consists of the following items:

- Net financial statement income from a trade or business with certain modifications, such as depreciation/amortization to the extent allowed by tax law, entertainment limited to 50 percent of costs, federal income tax not deductible, etc.
- Interest income with exclusions for government bond interest from certain income taxes.
- Dividend income with 70- to 100-percent exclusions for certain inter-corporate payments.
- Rents, royalties, pensions, annuities, etc.
- Salaries, wages, commissions, fees, etc.
- Gains on sales of stocks, bonds, land, buildings, artwork, etc. (generally called capital gains).
- Other miscellaneous gains, profits and income from most sources including lotteries, betting and “illegal” gains.

Other types of trusts, partnerships, limited liability companies and certain corporations are considered "flow-through" entities and they are not taxed as an entity; their income (or loss) is flowed through to their owners or beneficiaries who then report such income (or loss) on their own tax returns.

Tax rates presently in effect (January 2011), range as follows:

	Corporations	**Individuals, estates, trusts**
Federal	15 to 39%*	10 to 35%
States	0 to 12%	0 to 11%
Localities	0 to 9%	0 to 4-1/2%

**Phase outs of lower brackets provide for uniform rates of 34% or 35% for corporations if taxable income exceeds certain levels.*

Dividends received by individuals from certain domestic and foreign corporations are taxed between 0 and 15 percent, depending on level of income.

Capital gains are taxed between 5 and 28 percent, depending on the holding period and nature of the gain. Gains on sales of principal residences are exempt up to $500,000.

The federal government and certain states have "alternative minimum taxes" (AMT) under which certain types of deductions are not permitted. For example, the federal AMT system limits the utilization of prior years' net operating losses to 90 percent of available amounts. The federal AMT rate is 20 percent for certain large corporations and 26 percent or 28 percent for individuals.

Filing of returns and payment of income taxes. Tax returns of individuals are generally filed on a calendar year basis. Corporations generally may select an initial fiscal year ending with the last day of any month. Under certain circumstances a tax return may be for a period less than 12 months. A tax return may never be for a period exceeding 12 months.

An individual's tax liability is paid by the withholding of tax by employers and, if required, by quarterly payments of estimated taxes. Penalties will be applied with certain exceptions, such as if estimated tax paid plus withholding tax on wages is less than 90 percent of actual tax liability. Alternatively, taxpayers can avoid penalties by paying 100 percent or 110 percent of the prior year's tax. Individuals must file a return three and a half months after the end of their reporting year, at which time any balance of tax must be paid.

Extensions of time for filing returns and for paying taxes (with interest) are easily obtained. Corporations, estates and trusts are required to pay their income taxes currently in quarterly installments and file returns annually based on their fiscal year.

Taxation of foreign corporations or individuals. Any corporation not organized or created in the United States is considered a foreign corporation. A foreign corporation pays U.S. tax at different rates for U.S. business-connected income and for U.S. non-business income.

Tax conventions and treaties with other nations are designed to eliminate the double taxation of income. All income that is effectively connected with a foreign corporation's U.S. business is taxed at the regular U.S. corporate rate. Effectively connected income, defined as all business or rental net income that a foreign corporation derives from sources within the United States, includes gains on sale of real estate and can include interest, dividends, rents, premiums, annuities, and other fixed or determinable periodical income.

In determining whether periodical income is effectively connected with a U.S. business, two factors are considered, first, whether the income is derived from assets used in, or held for use in, the conduct of a

U.S. business; and second, whether the activities of the U.S. business were a material factor in the realization of the income.

Comparable rules apply to non-resident individual aliens with U.S. source income.

Taxation of resident individual aliens. An alien will be considered a U.S. resident for tax purposes for a calendar year and be taxed on world-wide income (in the same way as a U.S. citizen), if the individual:

- Is a lawful permanent resident at any time during the calendar year (possesses a green card), or
- Meets the substantial presence test (SPT), an average presence of 122 days or more in the United States over a three-year period. Exceptions to the SPT include:
    - Years in which the individual spent less than 183 days here and had a tax home abroad, a closer connection to the foreign country than to the United States.
    - An individual is unable to leave the United States because of a medical problem that arose while here.
    - For periods when an individual was "foreign government related" or a teacher, trainee or student; those days are not counted.

Domicile rules determine taxability for estate or gift taxes.

Branch profits tax. Foreign corporations that operate businesses in the United States must pay a branch profits tax in addition to paying the corporate income tax or the alternative minimum tax. The tax is equal to 30 percent of the foreign corporation's dividend equivalent amount (essentially net income after all taxes). Changes in U.S. net equity of the foreign corporation determine whether the tax is imposed. Qualified resident corporations of various countries can be exempt from the tax (or be subject to a reduced amount), because of an income tax treaty between the United States and these countries.

Capital gains. A foreign individual or corporation's capital gain net income effectively connected with the conduct of a U.S. business or arising from a sale of U.S. real estate is taxed at the normal U.S. graduated tax rates. Otherwise, the gain (on securities, art work, collectibles, etc.), is not taxed. Thus a gain on the sale of an office building in downtown Cleveland would be taxed, but a gain on the sale of 2,000 shares of General Motors stock would not be taxed.

Treatment of remittances outside the United States and withholding tax system. There are no restrictions on remittances outside the United States. Payments to foreign entities for merchandise, purchases, loans, services rendered elsewhere, and interest on U.S. bank and financial institution deposits or on certain registered bonds, are not subject to any withholding tax and are deductible for income tax filings as long as the terms and conditions follow normal business practices in the industry in question ("arms-length standard"). Taxing agencies can scrutinize such payments and re-determine them as dividends (which are not tax deductible), if affiliated parties do not to business with one another on a normal basis.

Payments of periodical income (such as dividends, royalties, interest on loans, etc.), are however, subject to a 30 percent flat withholding tax unless it is reduced by treaty (generally to 5 or 15 percent).

Income of operating partnerships (including LLCs) is subject to federal income tax withholding of 35 percent (and up to 11 percent in some states), which can then be offset against the foreign recipient's ultimate income tax liability.

When a foreign individual or corporation disposes of real property, the proceeds are subject to federal income tax withholding of 10 percent of the amount realized to be applied towards the actual income tax on the transaction. Under certain conditions, the seller can apply to the Internal Revenue Service (IRS) for exemption from withholding by the buyer, such as when the sale would result in a taxable loss.

The federal and state governments require payers to file various annual information returns for payments of periodic income, services rendered, proceeds from sales of real estate, etc. and the related withholding taxes to foreign as well as domestic recipients. Failure to file these information returns as well as any other required returns can result in a variety of penalties and interest charges.

Corporate debt or equity; 'thin' capitalization. Corporations may favor heavy debt capitalization as opposed to equity, because interest paid on debt is deductible, while dividends paid on stock are not. A corporation's debt instruments may be treated as equity (stock) for federal income tax purposes, thus making the interest paid on them nondeductible. The IRS uses key factors to determine whether purported corporate debt will be treated as debt or equity for tax purposes. Some of the key factors are:

- The names given to the documents evidencing the "debt"
- The presence or absence of a fixed maturity date
- The right to enforce payment of principal and interest
- Whether the "debt" is convertible into stock, and
- The intent of the parties.

In addition, for most treaty countries, Section 163(J) of the tax code limits the deductibility of interest paid on debt provided by, or guaranteed by affiliates, if certain levels of debt to equity are not maintained by the U.S. group's corporate affiliates.

Employment taxes

Social security taxes (generally indexed to inflation), have been increasing and are imposed on both employer and employee. Currently, the employer and employee are each subject to social security tax at a rate of 6.2 percent on wages up to about $107,000 (maximum about $7,072 a year) and Medicare tax at a rate of 1 .45 percent on all wages. There are some reductions in these costs based on new jobs created, temporary stimulus, etc. The tax is payable by a foreign employer with U.S. employees, regardless of whether it has a permanent establishment in the United States.
Income taxes are collected under the employment and withholding tax system at the federal, state and city levels, at varying rates based on each jurisdiction's statutes. All withholding taxes are deducted by employers from gross wages and remitted to the appropriate agencies.

All the states tax payrolls at rates ranging from 0 to 11 percent (on the first $7,000 to $30,000), to fund unemployment or disability benefits; the federal government also collects an unemployment tax of about $56 an employee.

Estate and gift taxes

The United States and many of the states tax transfers of property during a person's lifetime or at death; there are annual and lifetime exclusions.
The Federal tax rate is 35 percent in 2011 & 2012. Federal law provides annual gift tax exclusions of $13,000 and a total or lifetime "unified credit" which is equivalent to a $5 million exclusion. Absent new legislation these rates will be higher starting in 2013.

U.S. real and personal property of non-resident aliens is subject to U.S. estate taxes with some exemptions available to treaty country decedents. However, U.S. real property owned by foreign corporations is not subject to U.S. estate taxes.

Real and personal property taxes

Most states and/or localities levy taxes on real and personal property, generally based on the property's market value. These taxes provide most of the funding for these governments, which provide services such as police and fire protection, garbage collection and street cleaning.

Sales taxes

Most states and/or localities levy taxes on the retail sale of goods and on certain services. These taxes range from 0 to 10 percent and often provide exemptions for items considered as necessities, such as food, children’s clothing and medicine. There is no federal sales tax, but there has been discussion of such a tax patterned on European value-added taxes.

Excise and miscellaneous taxes
All levels of government collect a variety of taxes and fees, which serve various special purposes or simply raise general revenue. These include the following:

- Excise taxes on certain trucks, cars, boats and airplanes.
- Excise taxes on telephone use, air transportation on cigarettes, gas, alcohol, etc.
- License and fees of varying amounts on driver and car registrations, professional or business licenses, fishing and hunting licenses, etc.
- Corporate franchise taxes on capital, usually with minimums of $50.

Exposure to taxes for treaty-protected entities
Provisions of many treaties exempt foreign corporations or individuals from federal income taxes on certain limited activities, such as storage of inventory, or short-term presence of employees. Careful attention needs to be paid to treaty requirements and state and local rules, which may require filing of information returns, income or sales tax reports based on local laws.

Tax administration and dispute resolution
The tax laws of the federal government are embodied in the Internal Revenue Code and are administered by the IRS and other branches of the U.S. Treasury Department. Any assessment made by the IRS may be appealed within the IRS to its Appellate Division. If the appeal is rejected, a protest may be filed with the U.S. Tax Court, a special court that decides tax controversies. As an alternative, the taxpayer may pay the deficiency in tax, file a claim for refund and file suit in the U.S. District Court if the claim is denied. Decisions of the U.S. Tax Court or U.S. District Court generally may be appealed to the appropriate U.S. Circuit Court of Appeals and eventually to the U.S. Supreme Court.
Similar processes exist at the state and local levels. Interstate controversies are referred to the federal courts with the ultimate resolver being the Supreme Court.

Suggestions for potential investors
Many foreign companies have succeeded by following a carefully thought-out list of do’s and don’ts. Here are some that may be helpful for the foreign concerns wishing to do business in the United States:

Do’s:

- Approach the U.S market with confidence.
- Thoroughly investigate all methods of distribution and forms of doing business in the United States.
- Consider a complete market study to decide where and to whom your product should be offered.
- Consider the market location for the product and related factors, such as type of labor and space requirements.
- Achieve an optimum mix of foreign and American expertise in building a U.S. staff.
- Be aware of pertinent factors, such as exchange rate volatility and U.S. tax and import regulations in setting up a pricing structure.
- Investigate the credit and financial standing of any U.S. customer that will buy goods on credit.

Don’ts:

- Don’t finalize the form of doing business without first consulting U.S. professionals on legal and tax implications.

- Don’t overlook the combined effects of state and local income and property taxes as well as financial incentives offered in certain localities before deciding where to set up your offices.
- Don’t overemphasize foreign language proficiency as a qualification for individuals to be hired in the United States.
- Don’t leave yourself exposed to currency fluctuation. Hedging transactions in some form is usually necessary to establish price stability for your product.
- Don’t assume the price structure in your home country is optimum for the U.S. marketplace.
- Don’t assume that because your product is a household word in your country it will be known or accepted readily in the United States.

Conclusion

Investment in the United States is now easier and more promising than it has been for quite some time. With the dollar near historic lows and with prices of U.S. property and companies battered by restructuring, opportunities abound. In addition, it is easy to enter the world’s largest market in various ways, to deploy capital and resources here and start new production facilities. With the world economy more and more interdependent, international commerce is a necessity for even small business.