



Hoberman & Lesser
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

Foreign Companies Doing Business in the United States

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Forms of Business Organizations

U.S. Corporation

A corporation, has limited personal liability, is the form of organization most common in the US. Many of the procedures and requirements are similar to those relating to the formation of companies in the UK, except that a US Corporation is subject to the specific corporate law requirements of the state in which it is incorporated. Thus, for example, a US corporation incorporated in New York may have certain restrictions placed on it by New York corporate law, which will not be relevant for a Florida corporation.

In fact, the state known for its most liberal corporate law requirements is Delaware, and even though a US corporation may be conducting business activities in, for example, New York, and therefore be subject to tax in that state, it may be incorporated as a Delaware corporation to obtain the greatest flexibility with respect to future changes in its charter. The charter, or articles of incorporation, contains the objects and other provisions relating to the corporation, and must be filed with the Secretary of State in the state in which the corporation is created.

A Branch of Foreign Corporation

A foreign corporation may establish a branch within the US to conduct its business activities even though most foreign corporations choose to form subsidiary companies for tax and non-tax reasons. Most countries have the ability to subject foreign corporations to domestic taxation if they form a branch, open an office, employ staff, maintain inventory or fixed assets or otherwise conduct business activities in the U.S. which enables the Federal and state taxing administration to assess the foreign corporation as though it had a deemed permanent establishment.

The US and state governments have the concept of taxable income “effectively connected” with a US source, and if a foreign corporation has “effectively connected” income, then the foreign corporation will be subject to US tax on such income the same way as a US domestic corporation. Moreover, if 25% or more of a foreign corporation's gross income is effectively connected, then any dividends paid by the foreign corporation to a non-US resident will be subject to US withholding tax unless an applicable tax treaty provides otherwise.

U.S. tax law also imposes a 30% branch profits tax, in addition to U.S. corporate-level income taxes, on a foreign corporation's U.S. branch's earnings and profits for the year. The branch profits tax may be reduced or eliminated entirely if a treaty so provides.





Partnership

General and limited partnerships may be formed, normally by means of a written partnership agreement, which is usually registered under state law. For legal purposes, a partnership is defined as an association of two or more persons formed to carry on a business for profit as co-owners. As defined for U.S. tax law, a partnership includes a syndicate, pool, joint venture or other unincorporated organization by which any business is conducted - and which is not, for federal income tax purposes, a corporation, trust or estate. Each state and the District of Columbia has its own laws governing the formation and operation of partnerships.

Partnerships are treated as conduits for U.S. income tax purposes, and each partner recognizes a proportionate share of income, loss and credit, whether or not it is distributed to the partners. Partnerships allow for much flexibility for allocation of profits and losses, as well as distributions. Any partnership engaged in a trade or business in the United States that has foreign partners must withhold U.S. tax on the foreign partner's distributive share of business income.

Limited Liability Company ("LLC")

Limited Liability Companies are a relatively new but increasingly popular form of organization in the US. The LLC is usually defined from a US legal perspective as a company - statutorily authorized in certain US states - that is characterized by limited liability to its owners, management by members and limitations on ownership transfer. As a legal entity, the LLC is able to own property in its own name, incur debts and other liabilities, enter into contracts, and initiate judicial proceedings. The LLC is a relatively new business form in the US that allows members flexibility to manage the entity's internal affairs; in fact, most state statutes permit LLC members to participate in the entity's management without sacrificing their limited liability protection. As with other legal entities, state (not federal) law governs the creation of an LLC. A multi-member LLC is treated as partnership for US federal tax purposes unless it elects to be taxed as a corporation. A single member LLC is treated as a disregarded entity for tax purposes unless it elects to be taxed as a corporation. The election to be taxed as a corporation must be made within 75 days of the beginning of the LLC's fiscal year in order to be effective for that year.

LLCs become very appealing to foreign investors who are concerned with the cost of taxation at the corporate level and the litigious nature of American society.



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Taxation



1. Income taxation

- Under the current law, Federal corporate tax rates on income and net capital gains are on a graduated basis and range from 15-35%.
- A foreign corporation engaged in business in the U.S. is taxed at regular U.S. corporate tax rates, but only on income that is effectively connected to the U.S. for that business.
- The U.S. source income that is not derived from assets used in the U.S. trade or business of a foreign corporation and that is not effectively connected with a U.S. trade or business or attributable to the foreign corporation's permanent establishment in the United States (such as dividends, interest and royalties) is subject to the 30% rate (or lower rate under an applicable treaty).
- The states and some municipalities (e.g., New York City) generally impose corporate income tax at rates varying between 1% and approximately 12%. These taxes are levied on US and foreign corporations conducting business activities in the particular state so that, for example, a Delaware corporation with an office in New York will pay New York state taxes as well as any Delaware taxes payable as a result of business operations in Delaware. The calculation of the state tax is generally based on the taxable income declared for federal tax purposes, subject to minor adjustments. The taxable income can be, subject to certain limitations, allocated between the states so that the entity is not taxed twice on the same income. Each state has its own allocation formula, although most use either the three factor formula (sales, payroll and assets located within the state) or a single factor of sales within the state.

2. Sales taxes

- Sales taxes are imposed at state and local levels, as opposed to the federal level, in respect of products and certain services sold within the United States. In this respect, it differs from a value added tax

system in that it is a consumer tax which is only levied once at the point of consumption, as opposed to throughout a chain of transactions leading to final consumption. Sales tax is imposed at the rate in effect in the state and/or locality where title to the goods passes and not based on the rates in effect at the shipping point. The applicable rates of taxes vary from state to state and locality to locality, at rates of between 2.9% and 9.98%, with exemption generally given for food and medical products (for example the rate of sales tax in New York City is currently 8.875%). Also, merchandise that is being purchased for re-sale is often exempt from sales tax. Moreover, sales taxes are not levied on intangible property, e.g. royalties regarding copyrights, as compared to the VAT system in EU countries.

- All Companies that are required to collect and remit sales taxes must register with the appropriate state(s) where they have established nexus prior to the start of business. For example, New York State requires that the sales tax registration form be filed 20 days prior to the start of business.
- Even wholesale companies may have to register as sales tax vendors with the state in order to accept re-sales certificates from their customers and to buy certain items (such as raw materials, machinery, equipment and electricity used in production) without paying sales tax. A resale certificate is an official document that allows a purchaser to make tax-free purchases that would normally be subject to sales tax, if they intend to re-sell the property or service.
- Additionally, some states require that the purchaser of an existing business file a bulk sales tax return and pay sales tax on the acquisition of certain assets, such as furniture and fixtures, computers, and other non-capitalized goods and supplies.

3. Payroll taxes

- Social security taxes will need to be paid by resident individuals working within the US by both employer and employee at the rate of 6.2% each on the first \$127,200 of salary (for 2017), plus a “Medicare” tax, again payable by employer and employee at 1.45% of the entire salary with no limitation.

However, under any of the totalization agreements entered into by the US, foreign nationals will not need to pay social security taxes in the US if they are transferred temporarily to the US for a period of less than five years, provided they remain subject to social security tax in their home country (not all totalization agreements have the five-year rule). Moreover, they would still be entitled to benefits within the US, provided that ultimately the foreign national has contributed to the social security system for at least 18 months in the US.

There are also other types of payroll taxes such as Federal Unemployment Insurance, State Unemployment Insurance, as well as insurance

requirements such as Workers’ Compensation Insurance and State mandated Disability Insurance.

Transfer Pricing

The IRS increases its scrutiny on transfer pricing when related United States and foreign group members are involved. Regulations were issued that reinforce the “arms-length” standard while increasing the emphasis on comparability and documentation. Arms-length transactions are identified as transactions between two unrelated companies. Transactions between a holding company and its wholly owned subsidiary are not considered at arms-length.

Several methods are permitted to determine a proper arms-length price, including the use of transaction comparables, comparable profits and profit split methods. Taxpayers must identify and document the best method, depending on their circumstances. Failure to maintain simultaneous documentation of pricing determinations, including a written transfer price study, could result in

substantial penalties - as much as 40% of the tax due related to the transfer pricing adjustment. IRS adjustments also could result in double taxation since some treaty country partners may not give correlative adjustments in U.S. transfer pricing cases. In cases where a treaty country is involved, consult a competent authority on inter-company transactions.

To mitigate controversies in transfer pricing disputes, the IRS encourages using Advanced Pricing Agreements (APA). An APA is a prospective agreement between the IRS and the taxpayer to determine compliance with the arms-length standard. It is expected that when treaty partners are involved, the competent authorities in the relevant countries will be involved in the process. If possible, taxpayers should seek bilateral, and possible multilateral, agreements to ensure the pricing strategy is agreed upon by all countries involved.



Contact Us

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Our NYC accountants serve a broad cross section of businesses, ranging from publicly held companies, to private sector businesses, to individual entrepreneurs throughout the tri-state region and across the United States. Besides understanding the challenges you encounter, our professionals provide sound, creative thinking to help you take advantage of opportunities and avoid pitfalls.



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MGI Worldwide Key Contact and Managing Partner at Hoberman & Lesser, Robert Hoberman has over 30 years of experience in management consulting, working with all types of businesses. His expertise ranges from structuring business deals, tax planning, and estate and gift planning, valuations, including the use of trusts. He also has extensive familiarity dealing with banks and financial institutions, as well as tremendous knowledge of data processing, systems analysis, and consulting for commercial applications.

A graduate of Syracuse University with a B.S. in Accounting, Robert is a Certified Public Accountant in New York, New Jersey, Connecticut and Florida. He is a member of the American Institute of Certified Public Accountants (AICPA) and the New York State Society of CPAs (NYSSCPA).

In 2008, Robert received the Humanitarian of the Year award for his work with the NYC Chapter of The Crohn's & Colitis Foundation of America (NYC CCFA). He currently serves as a board member for the Lester M. Entin Foundation.

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