Before You Take Your Company to the U.S.

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If you think that the international expansion of your business will be tedious, uncertain and difficult, you are definitely not the first ones to tell us so! This article aims to review the most common legal considerations to take into account when expanding into the US market. The process should be mapped out for you and guided from start to finish by a specialist legal team.

Primum Law Group is a boutique law firm that specializes in advising and representing international companies of all sizes and operating in all industries which are exploring how to take advantage of business opportunities offered by the US economy. We know that the exercise of international business planning is multi-faceted and complex. This is because, for success, the process has to extend beyond merely identifying new markets for the products and services of the company.

Your company has been domestic-focused and now needs to identify how it can obtain the resources needed in order to implement a global strategy. You also need to identify the potential risks involved in the process and the ways you can best mitigate them. We walk you through a series of essential analytical questions. We clarify the potential legal issues that have to be taken into account in relation to your planned expansion. We help you strategize the steps of this expansion by designing and implementing efficient, cost-effective legal structures and business operating models that get your business where you want it to be.

In the big picture, the process includes getting clear on your business goals, the incorporation options, immigration rules, taxation obligations, intellectual property protections, labor and employment laws, product liability risk.

1. Form of Legal Presence in the US.

At the initial stage of the work with the companies that are interested in starting their business operation in the US, it is about understanding why they want to expand into the US.

We have an extensive discussion about their "Why", their goals. We get them to understand the balance of flexibility, risk and the amount of control they want to maintain while achieving their goals.

Many foreign companies do business in the US as corporations. Corporations are organized under state law and each state has its own rules for creating and operating corporations. In the US a corporation may be created under the laws of one state and have its principal place of business in a different state.

For instance, we might work with a company that is interested in an extension of their consumer market to the US where they wish to sell their goods. The first issue is this: Does this business have to form a corporate entity in the US in order to start selling its goods here? Not necessarily. A foreign company is not required to conduct business in the US through a US entity

and could instead open a branch office. It would significantly reduce the initial capital investments and provide flexibility. However, launching in this way, the foreign company may expose all its revenue to taxation in the US. The business's liability would not be limited to liability incurred at the branch level, and because of this risk, foreign businesses coming to the US do not generally elect to open a branch office unless specifically advised to do so by a US attorney.

This type of discussion allows us to identify the right type of legal entity that could be used (and the best state for their purposes); we clarify all the potential pros and cons of the suggested structure.

The most common types of domestic business entities are corporations, limited liability companies (LLCs) and partnerships. An LLC, like a corporation, is formed by registering with the Secretary of State in the US state in which the company is to be created. Both are governed by the laws of the state in which the entity is formed. LLCs offer flexibility with respect to how the company can be financed and managed. Unlike corporations, LLCs can elect to be taxed as a corporation or to have income 'pass through' to members and be taxed at the member level. Many foreign companies prefer to be taxed at the corporate level to avoid having distributions to members reflected on their personal tax returns.

Each business form has its own benefits and the choice of one depends on case-specific legal and business factors. As two examples: If we work with a technology company that is interested in raising capital in the US, we form a C Corporation in Delaware; a trading company owned by a few members planning to do online sales might be a Nevada Limited Liability Company.

Another side of this study is with a relocation of the corporate center to the US. If the company decides to move the headquarters to the US, key determinants – 1) company parenting style and legacy; 2) importance of clustering; 3) the quality of living in the chosen metropolis; 4) infrastructure; 5) taxation; 6) corporate governance; 7) legislature – should be carefully considered.

2. **Immigration.**

Transferring employees (specialist staff; executive management) from the home market to the US could be a part of the process of international expansion and, in this case, immigration law should be taken into account.

All foreigners coming to the US to work must obtain permission to do so in the form of a visa. US visa laws are complicated and strictly federal. Some types of visa have requirements and limitations on the corporate structure that have to be considered before the company is formed.

For instance, with an L-1 visa that can potentially be converted into the green card there are more rigid requirements for the corporate structure, compared to an E-2 (entrepreneur's) visa. However, E-2 visa rules do not allow its conversion into 'permanent resident' status.

It is critical for foreign business owners and their workers to adhere to the terms of their particular visa as any violation can result in removal from the US or denial of re-entry into the US.

3. **Taxation.**

Given the complexity of US tax law (at the federal, state and local levels), careful tax planning and counsel is important for all companies doing business in the US.

Companies in the US are subject to separate federal, state, and local taxes. The federal government, through the Internal Revenue Service (IRS), collects income tax, capital gains tax, tax on dividends and earned interest, other passive income and employee payroll taxes. Businesses will also have a number of additional tax obligations in the state in which they conduct business.

Tax Treaties

The US is party to bilateral tax treaties with numerous foreign countries. If your home country has a tax treaty with the US, the tax treaty should be consulted as your business's primary tax planning tool.

These treaties have significant differences among them, but all of them aim to facilitate commerce between countries while preventing double taxation and tax evasion. Operating through a US entity such as a corporation eliminates some of the concerns about double taxation that foreign companies rely on tax treaties to resolve.

Many treaties set forth the conditions under which a foreign company has a 'permanent establishment' in the US, which affects whether the business will be subject to federal income taxes. As an example, if a provision of a relevant tax treaty results in a foreign company owing less federal income tax, this benefit must be claimed on the company's federal income tax return and the specific provision must be cited on the return form. Failing to comply with this requirement can result in significant penalties.

Controlled Foreign Corporation

The Controlled Foreign Corporation (*CFC*) rules were created and are managed by the Internal Revenue Service – which manages such CFCs' taxation within rules designed to limit artificial deferral of tax by using offshore low taxed entities. Under the section of the IRS code called 'Subpart F', certain types of income of CFCs, though undistributed, must be included in the gross income of the US shareholder in the year the income is earned by the CFC.

Corporate Income Tax

A corporation formed in the US is subject to federal income taxes on all of its income – meaning income earned anywhere in the world. The tax is levied on net taxable income, which is gross income less allowable deductions. There are a wide variety of deductions available to taxpayers and the rules governing those deductions are complex.

Companies in certain sectors may also be eligible for tax credits, which are often used to incentivize investment in emerging industries like renewable energy. Tax credits are particularly valuable compared to deductions because they reduce a company's tax bill dollar-for-dollar.

Transfer Pricing

Foreign companies doing business in the US may not shift profits to a foreign parent company to avoid taxes. The practice of 'transfer pricing' occurs when a foreign parent company charges the US subsidiary exorbitant (i.e.: far above the practiced market rate) prices for goods, or

for services such as inventory or management services, in order to move pre-tax money overseas. The IRS can investigate companies for this practice and may impose steep penalties for violations. Defending a US tax audit is expensive and time-consuming, further adding to the non-compliance penalty amounts. Any short term benefits gained are outweighed by the risk of being audited and caught by the IRS.

Individual/Expatriate Income Tax

Individuals that are US citizens or US resident aliens are subject to tax on their worldwide income, regardless of where they work or live. Generally, an individual is considered a US resident for tax purposes when they either obtain legal permanent residency status or are present in the US for at least 183 days of the latest tax year. Even if an individual is not a US resident or legal permanent resident, such individuals must still pay US federal income tax on income earned in the United States.

In either case, a foreign individual would benefit greatly from proactive tax planning with a US tax professional. Such professionals are aware of the numerous deductions, exemptions, and tax credits that minimize tax liability and ensure compliance with the law. As is the case with corporate income taxes, individuals can be subject to harsh penalties for failure to pay US taxes.

4. **Intellectual Property.**

The US has robust intellectual property (IP) laws that protect intangible assets adding value to businesses and distinguishing brands and products. There are four primary forms of intellectual property in the US: patents, copyrights, trademarks, and trade secrets.

When technology companies consider international expansion, it is the IP strategy which is very important to get right.

Regarding Trademarks:

It is important to grasp that trademarks are territorial and must be filed in each country where protection is sought. Companies should note that foreign patents are likewise unenforceable in the US. A foreign company introducing a unique product into the US market may be able to obtain protection for its invention by securing a US patent, provided that the invention has not been marketed or sold in another country. Obtaining a patent in the US requires US patent counsel (specialist attorneys) and can be time-consuming and expensive.

The Madrid Protocol makes it easier to register a trademark in multiple countries. By filing one application with the USPTO, US applicants can concurrently seek protection in up to 84 countries. Each national trademark office then examines the application in accordance with domestic law as though it had been filed directly with that country.

Under the Paris Convention of 1883, trademark filings in a signatory country that are made within six months of filing in another signatory country are treated as if filed on the date of the original filing. A qualified foreign applicant who owns a valid registration from the applicant's country of origin can obtain a US registration on the basis of that foreign registration, also subject to certain conditions.

Copyrights:

Copyright protection is available for literary, musical, architectural, artistic, graphic, sound recordings, and other works that are written down or otherwise fixed in a tangible medium. The exclusive rights granted to the copyright owner include the right to reproduce the work, prepare derivative works based on the original, distribute copies of the works, perform the work publicly, and display the work. Both published and unpublished works are protected by copyright.

Copyright protection is automatically secured when the author creates the work—registration is not required for protection. This protection applies to unpublished works regardless of the nationality or domicile of the author. As a result of various treaties to which the US is a party, published works authored by foreigners may also be protected by US copyright law if certain conditions are met. Although registration is not required, federal registration does confer substantial benefits, including the ability to enforce the author's rights in court and to obtain additional remedies for infringement. Registration is easily completed through the Copyright Office.

Trade Secrets.

A trade secret is any information that adds value to a business or provides a competitive advantage to the owner because the information is not known by others. For example, a trade secret could be a formula, a device, a compilation of data, or a manufacturing technique. Trade secrets are broadly protected by state law in all 50 states. Trade secrets are also protected under federal law as of the May 2016 passage of the Defend Trade Secrets Act. The owner must make reasonable efforts to maintain the secret for continued protection. Trade secret law can protect intellectual property that is not patentable but is crucial to a company's operations or product. Companies often require that employees sign agreements to protect trade secrets.

5. **Labor and Employment.**

Foreign businesses coming to the United States must comply with US labor laws when hiring employees (US citizens or legal residents) who will be working in the US.

US laws notably distinguish between 'employees' and 'independent contractors'. Employees are subject to tax withholding requirements and protected by federal labor laws. Independent contractors, on the other hand, are not subject to tax withholding requirements and are not covered by many labor laws, such as federal minimum wage. A correctly 'labeled' independent contractor exercises a greater degree of behavioral and financial autonomy than an employee.

Companies doing business in the US need to be aware of these distinctions and accurately classify workers. If a government agency or court determines a worker is actually an employee rather than an independent contractor, the employer can be liable for back taxes and civil claims under labor laws.

Contracts governing employee relationships between foreign owners in the US and foreign employees in the US must also comply with US law. Many companies enter into employment

contracts with their key home-country employees – executives, officers, top managers, and others whose technical or commercial skills are integral to the business's success in the US. Keep in mind US law governs this employment.

US employment contracts may set the scope and term of employment and the conditions under which the parties can terminate the relationship. Absent such an agreement, the employment agreement is considered 'at-will' by both parties – meaning that the employer or employee may terminate the relationship for any lawful reason without notice in nearly all US states.

6. **Product Liability.**

US product liability laws differ greatly from product liability laws in other countries. Unlike many other countries, a majority of US states have adopted the doctrine of strict liability in tort. The adoption of strict liability expands the scope of entities that can be liable for product injuries and lessens the proof necessary to establish such liability. Under strict liability, a company anywhere in the production chain (manufacturers, wholesale distributors, retailers) can be liable if they sell a product in a defective condition that is 'unreasonably dangerous' to the user. This is true even if the seller was not negligent (meaning the seller exercised reasonable care) and even if the consumer did not enter into a contractual relationship with the seller. The focus of the inquiry is on the product and not the conduct of the seller.

A company could also be held liable to an injured consumer under a separate negligence theory, or for breach of warranty. A company is negligent if it fails to meet the standard of care that a reasonable company should have exercised under the circumstances, such as in the design or manufacture of the product. A company could also be found negligent for failing to warn consumers of a product's dangers. Warranty claims arise from a contractual relationship between the injured person and the seller of the product. In the US, warranties may be express (explicit) or implied.

Unlike many other countries, damages for product liability cases in the US are commonly decided by juries and may include compensation for all direct and indirect losses caused by the injury. This means that the amount of damages in product liability cases can be very high.

Because the entire production chain could potentially be liable for harm caused by a product, it is important for businesses to include 'indemnification provisions' in US sales contracts. An indemnification provision is an agreement by one party to compensate the other for certain costs and expenses. Under a typical indemnification clause, the obligor (the party giving indemnification) agrees to reimburse the obligee (the party receiving indemnity) for any losses, liabilities, claims, or causes of action that arise from or are related to injuries caused by the product. It is also possible to negotiate a defense clause where one party agrees to defend the other against lawsuits filed by injured third parties.

In addition to negotiating indemnification and defense clauses, foreign companies doing business in the US should consider carrying adequate insurance coverage to protect against product liability claims.

In Conclusion

As stated, this is only a ‘big picture’ presentation of the process of expanding your business operations into the United States. Your legal team will take you through the full process and dive deeper into the details with you. There are many advantages and benefits to business expansion outside your own borders, but make sure you are guided by an experienced team of professionals to smooth the way and save you time, energy and money…and allow your business to launch, sell and profit more quickly.

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