



Introduction

The U.S. is often called "the land of opportunities." While our markets may be ripe with opportunities, there are also various rules and regulations, along with potential threats and risks, that non-U.S. investors should consider before participating in the U.S. marketplace.

KLR's Guide to Doing Business in the U.S. provides answers to frequently asked questions that our international business experts often hear from clients looking to:

- Start a new U.S. business.
- Invest in an existing U.S. business, or
- Expand or move a foreign business into the U.S.

Reading this guide will help non-U.S. investors understand our marketplace, including its:

- Business environment,
- Business structures,
- Taxation,
- Financial reporting, and
- Employment laws and regulations.

Ultimately, this guide is designed to help non-U.S. investors answer the questions: Should you participate in U.S. markets? And, if so, how should you proceed?













Why are investors attracted to the United States?

For the last century, the U.S. has been the economic hub of the world. Today, it continues to receive more non-U.S. investment than any other country.

Top reasons non-U.S. investors pursue business opportunities in the U.S. include the following:

- The U.S. has the world's largest consumer base and financial market with a gross domestic product (GDP) of \$20.66 trillion.
- The U.S. economy is growing. Third quarter 2018 GDP growth was 3.4%.
- The U.S. has a fair and easy-to-understand legal system and various regulatory sectors in place, making it relatively easy to start and operate a U.S. business.



6

Business Environment

- The U.S. allows domestic businesses to choose between various legal entity structures, including (but not limited to) corporations, limited liability companies (LLCs), joint ventures and partnerships. Alternatively, a non-U.S. company may operate as a subsidiary or branch of a foreign parent company if it doesn't want to conduct business through a U.S. entity, but that setup may result in higher income taxes.
- The U.S. accepts businesses from all over the world and encourages foreign investments by offering tax incentives and providing a business-friendly atmosphere to prospective non-U.S. businesses.
- The U.S. has a skilled labor market. There's no shortage of innovation or productivity within the U.S. workforce.

What factors can lead to success — or failure — in U.S. markets?

With GDP over \$20 trillion, the U.S. is the world's largest market, serving as an intermediary for international businesses to invest in or expand business operations. Accessing the U.S. marketplace has become a marketing strategy for non-U.S. businesses to improve their global competitiveness.

In 2021, non-U.S. businesses directly invested \$190.7 billion in U.S. ventures. Will these investment opportunities be successful? That depends. Factors that affect the U.S. economy and its participants include:

- Inflation,
- Interest rate changes,
- Supply and demand variations,
- Trends and economic outlook,
- Human and capital resources,
- Current events, and
- Federal, state and local laws and regulations.

Changes in these factors may affect the U.S. economy, causing periods of growth and recession. So, it's vital for a non-U.S. business investing or operating within the U.S. to monitor these factors.



Business Environment

How does government regulation affect U.S. businesses?

Government regulations have been established in the U.S. to protect employees, consumers and stakeholders, as well as to prevent financial disasters. There are generally few regulations on foreign trade, because the U.S. benefits from non-U.S. investments and its marketplace is readily accessible.

A significant factor in determining how a business invests in the U.S. market is regulations governing imports, exports and the associated tariffs. Those regulations often depend on the industry in which a company operates. In addition, fees and duties may be assessed based on the nature of the operations or investment. These costs can be heavily reduced or avoided by operating a business within the U.S.

U.S. businesses are governed by federal, state and local regulations. Federal requirements provide a base on which state and local governments can impose additional requirements. Some states are very strict in relation to non-U.S. business operations, while others promote international commerce and simply use federal guidelines.

Before launching a U.S. startup or moving an established foreign business to the U.S., it's critical to evaluate the regulatory environment. A legal professional can help identify a city or state that caters to the needs of non-U.S. business and the company's industry.



Business Environment

How does the U.S. financial system affect businesses?

The U.S. financial system is regulated by federal and state laws and regulations. Financial regulation is necessary for:

- Market efficiency and integrity,
- Consumer and investor integrity,
- Capital formation and access to credit,
- Taxpayer protection,
- Illicit activity protection, and
- Financial stability.

The Federal Reserve serves as the central bank of the U.S. "The Fed" sets monetary policy and the base of interest rates of the country. It also:

- Conducts the nation's monetary policy to promote maximum employment, stable prices and moderate long-term interest rates in the U.S. economy,
- Promotes the stability of the financial system and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad.
- Promotes the safety and soundness of individual financial institutions and monitors their effects on the U.S. financial system,
- Fosters payment and settlement system safety and efficiency through services to the banking industry and the U.S. government that facilitate U.S.dollar transactions and payments,
- Promotes consumer protection and community development through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.



There are 12 Federal Reserve banks in the U.S., each monitoring its independent district. The duties carried out by the Federal Reserve promote the effective operation of the U.S. economy and, more generally, the public interest.

Financial intermediaries — such as commercial and investment banking institutions — are vital to the U.S. financial system. These financial resources are generally easy to access, and can provide non-U.S. investors with readily available capital funding. Funds can also be generated through common and preferred stock issuance and other sources.





There are many legal structures to consider when investing in or starting a U.S. business — or moving a foreign business to the U.S. Examples include:

- Corporations,
- Limited liability companies (LLCs),
- Joint ventures, and
- Partnerships.

A non-U.S. company may also be able to operate as a subsidiary of its parent company if it doesn't want to conduct business through a U.S. entity. Or a foreign investor may acquire an existing U.S. business to gain access to U.S. markets.

What is an LLC?

An LLC is a business structure granted by state statute. Each state has different regulations; so, it's important to review a particular state's regulations before starting an LLC in the state. One of the advantages of an LLC is that it provides its members with limited liability, similar to a corporation. LLCs also offer certain tax benefits.



Business Structures

LLC owners are called "members." There's no maximum number of members, and most states allow single-member LLCs. A single-member LLC is treated as a disregarded entity for tax purposes, and its income and expenses are reported directly on the individual member's income tax return. An LLC with at least two members is classified as a partnership for federal income tax purposes unless a form is filed with the IRS electing to be classified as a corporation.

An LLC that doesn't want to accept its default federal tax classification, or wants to change its classification, can use the Entity Classification Election form to elect how it will be classified for federal tax purposes. Generally, an election specifying an LLC's classification can't take effect more than 75 days prior to the date the election is filed. It also can't take effect later than 12 months after the date the election is filed. Late-election relief may be available in certain circumstances, depending on the facts.

How do partnerships and joint ventures compare?

A partnership is an agreement between two or more parties to conduct business together. Its overriding goal is to generate a profit.

A partnership must file an annual information report, but it's not required to pay income tax. Rather, income or losses pass through to the individual partners and are reported on their individual income tax returns. A partnership may be required to pay a withholding tax to the IRS for taxable income earned in the U.S. that's allocable to non-U.S. partners.

Conversely, a joint venture is a temporary partnership in the form of an agreement between two or more companies to conduct and carry out a specific project. The elements of a joint venture include:

- A community of interest in the performance of a common purpose,
- Joint control or right of control,
- A joint proprietary interest in the subject matter,
- A right to share in the profits, and
- A duty to share in the losses that may be sustained.



Business Structures

A joint venture's primary focus may not be its profits; rather, it strives to achieve an underlying purpose. Compared to a partnership, it's a less formal relationship that may be more limited in scope and duration.

How does a U.S. subsidiary work?

A subsidiary is owned and controlled (more than 50%) by another "parent" company. As a separate legal entity, a subsidiary has separate liabilities, taxation and governance from its parent company. A subsidiary is formed by registering with the state in which the company will operate.

A subsidiary must keep its own financial records. Any intercompany transactions between the parent and the subsidiary must be recorded.

Disadvantages of subsidiaries include the following:

- Liability can transfer from the parent to the subsidiary in a lawsuit (and vice versa).
- Operating as a subsidiary can be more complex from a legal, tax and accounting perspective than operating a standalone U.S. business.

Parent-subsidiary business arrangements are generally accounted for by consolidating the financial results of the parent company and its subsidiaries. A group of corporations, or subsidiaries, may elect to file a consolidated federal U.S. tax return when they're affiliated by at least 80% ownership with the parent company. This is advantageous for tax purposes when the profits of one business can offset the losses of another. Although the rules vary from state to state, most allow subsidiaries and parent companies to file consolidated tax returns.

A subsidiary operates like any company, and the parent has only oversight rights. If its parent company were to become involved in its subsidiary's daily operations, a subsidiary would no longer be a separate entity for legal purposes.



14

Business Structures

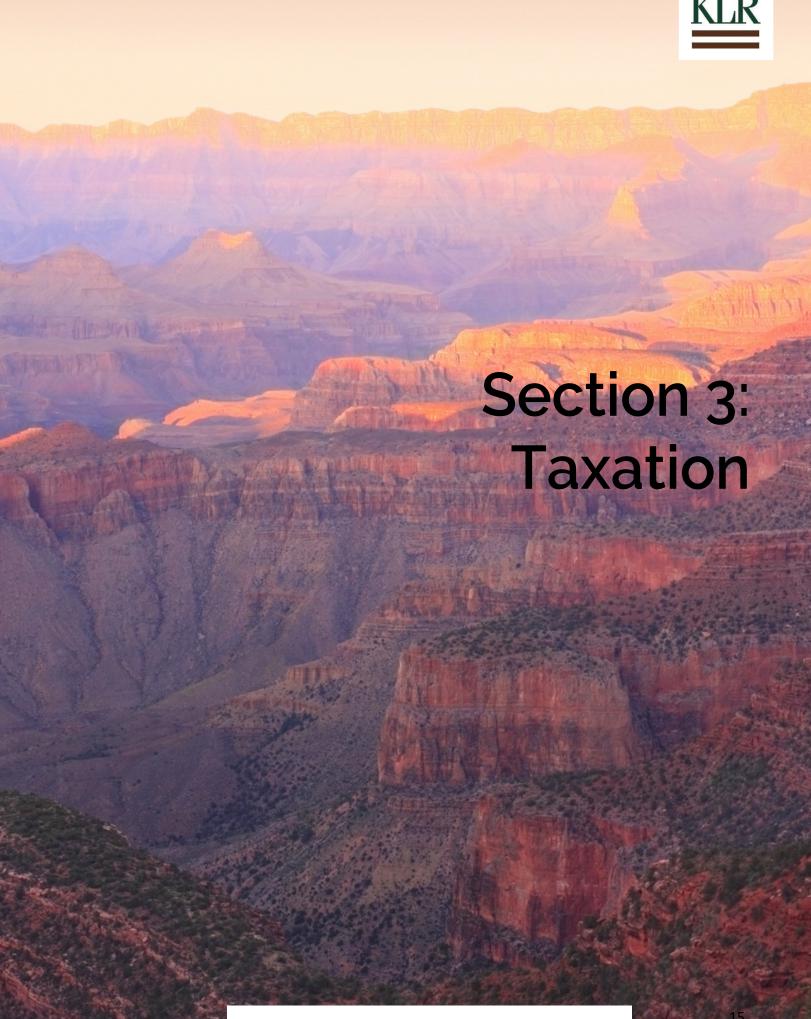
What does acquisition of a U.S. business entail?

There are three basic ways to acquire a U.S. business:

- 1. Merger or consolidation. A subsidiary formed in the U.S. can merge or consolidate with the parent company to form one entity. The new entity continues to operate either as one of the previous two companies or as an entirely new entity. All of the companies' assets and liabilities are combined under this method.
- 2. Asset acquisition. A buyer may purchase a company's assets instead of its stock. This structure, common in bankruptcies, allows the buyer to pick and choose certain assets and liabilities specified in the purchase agreement. This method also can be used to slowly gain control of a target company.
- 3. Stock acquisition. A buyer can purchase all or some of the shares of stock or ownership rights of the target company. Under this method, the buyer simply assumes the role of the previous owner, taking possession of all assets and liabilities. Various federal and state laws may apply to acquisitions of publicly traded companies.

The method of acquisition will have tax implications. Careful planning is essential to minimizing any potential adverse tax consequences.







The type of entity structure chosen to conduct business in the U.S. will determine the filing requirements, as well as how an entity is taxed.

How is business conducted in the U.S. by a non-U.S. business taxed?

Income earned by non-U.S. persons and entities from business and/or investment activities conducted in the U.S. may be subject to federal income tax and possibly state and local income tax. In addition to income tax, state and local governments may also impose sales, property and franchise tax.

When a foreign entity engages in a U.S. trade or business, all income from sources within the U.S. is considered Effectively Connected Income (ECI). A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit. However, an activity doesn't need to generate a profit to be considered a trade or business; it just needs to have a profit motive.



Whether an entity is engaged in a U.S. trade or business in the U.S. depends on the nature of its activities. In general, an entity is engaged in a U.S. trade or business when its employees perform personal services in the U,S.

Deductions are allowed against ECI, and it's taxed at graduated rates or a lesser rate under an applicable tax treaty. Tax treaties mitigate double taxation and may provide a preferential tax treatment for certain items.

All non-U.S. companies that qualify as a foreign entity under the federal tax code and are engaged in a U.S.-based business are required to file a U.S. income tax return. Non-U.S. corporations use Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*, to report income, gains, losses and deductions for the tax year. Income generated in the U.S. is broken into the following two categories:

- 1. ECI. This income is generated directly from the trade or business being conducted in the U.S. It's taxed at the normal income tax rates that apply to U.S. businesses.
- 2. Fixed, determinable, annual or periodic (FDAP) income. This is income that isn't generated directly from the trade or business being conducted in the U.S. It's taxed at a rate of 30% with the possibility of lower rates if a tax treaty is available.

If a non-U.S. corporation has an office in the U.S., it must file Form 1120-F by March 15. Companies that don't have a fixed office in the U.S. must file by June 15.

How are U.S. subsidiaries and branches taxed?

A subsidiary is a separate legal entity from its parent corporation. Most subsidiaries are formed as a corporation or LLC to provide more options to the parent corporation. The type of business structure will determine if the parent corporation is shielded from liability incurred by the subsidiary. A subsidiary is taxed on only its income, but it can be costly to set up.



On the other hand, a branch office does *not* have a separate legal entity from its parent corporation. Here, a parent corporation organized outside of the U.S. conducts business in the U.S. via a branch office. This is the simplest approach from an organization point of view, but it doesn't protect the parent corporation from any liabilities incurred by the branch.

A branch is subject to a branch profits tax. This type of taxation treats a U.S. branch of a foreign corporation as if it were a U.S. subsidiary of a foreign corporation for purposes of taxing profit repatriations. This makes the earnings and profits of a branch of a foreign corporation deemed remitted to its foreign parent and subject to the tax. However, an offset may be available if the parent corporation is a qualified resident of a country that has an income tax treaty with the U.S. and the treaty covers this type of tax.

How are partnerships and joint ventures taxed?

A partnership or joint venture may provide a quick way for a non-U.S. entity or person to start a business in the U.S. A partnership is considered a so-called "pass through entity" for tax purposes. Therefore, any profits or losses aren't taxed at the entity level; instead, they're reported on the tax returns of the individual partners.

In other words, the partners recognize their share of the income or loss on their personal tax returns. The partnership must file an annual information return to report the results from its operations, but it doesn't pay income tax.

If a partnership has ECI with a trade or business in the U.S., it must withhold on the income allocable to its foreign partners. This is known as partnership withholding. A partnership may have to withhold tax on a foreign partner's distributive share of FDAP gains and income not effectively connected with a U.S. trade or business, as well as withhold on any other FDAP income paid to a foreign person regardless of whether he or she is a partner.



Why is the distinction between residents and nonresidents important for tax purposes?

Whether an individual is taxed on his or her worldwide income — or on only a portion of it — is determined by his or her classification as a resident or nonresident under the U.S. tax code.

Residents. For U.S. tax purposes, a resident is a citizen, green card holder or individual who meets the substantial presence test. To meet this test, a person generally must reside in the U.S.:

- At least 31 days in the current year, and
- 183 days during the three-year period that includes the current year and the
 two years immediately before that. This includes: 1) all days in the current
 year, 2) one-third of the days the individual was present in the first year
 before the current year, and 3) one-sixth of the days the individual was
 present in the second year before the current year.

A resident alien can take into account available adjustments to income, deductions and credits to reduce their taxable income. Once an individual is considered a resident alien for tax purposes, all of his or her income becomes taxable no matter where it comes from or how it's earned.

It's possible for an individual to be both a resident and a nonresident alien (below) in the arrival or departure calendar year. This is known as a dual-status taxpayer. There's an election that can be made to treat the taxpayer as a full year resident for tax purposes, which may be beneficial depending on the facts and circumstances.

Nonresidents. A nonresident alien is someone who does not meet the residency definition or has an F, J, M or Q visa and meets the applicable visa guidelines to be considered a nonresident. Nonresident aliens must declare their U.S.-source income on Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, by April 15 or June 15, depending on the type of income received.



Generally, U.S. passive income — such as interest, dividend, annuities and rent — is subject to a 30% income tax withholding requirement unless a lower treaty rate applies. ECI after allowable deductions is taxed at graduated rates.

Capital gains have their own set of rules and are considered taxable if the nonresident alien is present in the U.S. for more than 183 days in the year. U.S. real estate interest gains are subject to tax under the Foreign Investment in Real Property Tax Act (FIRPTA). The applicable withholding rate varies depending on the amount realized on the disposition. Gains derived from the sale of intangible assets, such as goodwill and patents, are taxable if they're tied to the use of property located in the U.S.

Which federal excise and import duties apply?

An excise tax is a tax that government imposes on a producer or manufacturer, which then gets incorporated into the product's price and passed on to the consumer. Such items as gasoline, alcohol and tobacco products often have an excise tax. The U.S. government uses excise taxes to raise prices, thereby discouraging the use of certain products.

Import duties are taxes that a country's customs authorities impose on imports and/or exports. The <u>U.S. International Trade Commission</u> publishes duty rates from the Harmonized Tariff System. Import duties are often used to promote locally made products.

How has U.S. tax code changed in recent years?

The Tax Cuts and Jobs Act (TCJA) is a tax reform bill that was passed on December 22, 2017. The TCJA made sweeping changes to the federal tax code. Most business tax law changes are permanent, and most individual changes will sunset on December 31, 2025. Almost all the changes took effect on January 1, 2018.



Major TCJA changes that affect businesses include:

- Reduction of the corporate tax rate to a flat 21%,
- Creation of a 20% deduction of qualified business income (QBI) for certain pass-through entities,
- Transition to a territorial tax system,
- Introduction of the Global Intangible Low-Taxed Income (GILTI), which functions as a global minimum tax,
- Application of a one-time deemed repatriation tax to controlled foreign corporations with deferred post-1986 profits determined as of November 2, 2017, and December 31, 2017.

In 2021, the QBI deduction may be phased out for certain taxpayers with income above \$164,900, or \$329,800 for married people who file jointly. The GILTI will mostly impact foreign businesses with high annual profits compared to fixed assets.

Major TCJA changes that affect individuals include:

- Reduction of individual income tax rates,
- Adjustments of individual tax bracket amounts,
- Increase of the standard deduction,
- Limits (or elimination) of certain itemized deductions,
- Elimination of personal exemptions,
- Increase of the child tax credit from \$1,000 to \$2,000,
- Increase of the alternative minimum tax (AMT) exemptions and phase-out thresholds.





In addition to reporting income, expenses, gains and losses on their federal and state tax returns, U.S. businesses must report financial performance to investors, lenders and other stakeholders. The U.S. Securities and Exchange Commission (SEC) requires publicly traded companies in the U.S. to file quarterly audited financial statements that comply with U.S. Generally Accepted Accounting Principles (GAAP). Most private companies also follow GAAP either voluntarily, or they may be contractually obligated to do so.

What is GAAP?

GAAP financial statements show to prospective investors, lenders and buyers that the company has followed standard accounting practices. Compared to International Financial Reporting Standards (IFRS), GAAP is generally more prescriptive, relies more on historic cost, uses fewer estimates and offers more industry-specific guidance.



Steps to make your business GAAP compliant include the following:

- Hire staff with accounting degrees, training and experience.
- Continue to train staff on new accounting rules and technology.
- Use internal auditors to implement internal controls that prevent error or fraud.
- Hire external auditors to review internal controls and prepare financial statements.

U.S. businesses that aren't GAAP compliant may be given time to get up to speed. An experienced CPA can start the compliance process. Companies that are publicly traded will need to hire an auditing firm that's registered with the Public Company Accounting Oversight Board (PCAOB). The PCAOB is a private-sector, nonprofit corporation created by the Sarbanes-Oxley Act. It supports the implementation of standards and rules to improve the quality of audit services.





What rules apply to wages paid in the U.S.?

The Fair Labor Standards Act (FLSA) sets forth minimum wage, overtime pay and child labor laws. These regulations apply to both the private and governmental sectors.

The U.S. Department of Labor set the federal minimum wage at \$7.25 per hour as of July 24, 2009. State and local governments also have the power to set a higher minimum wage. An employee is entitled to the higher of either the federal or local minimum wage.

Employers generally must pay overtime after an employee has worked more than 40 hours in a work week. Overtime is paid at a minimum rate of one and a half times the regular pay rate. Certain exceptions apply for exempt workers, such as salaried managers.



27

Employment Laws and Regs

Child labor laws are established under the FLSA to protect the health and well-being of people under age 18 in the workforce. States also have the power to enforce child labor laws beyond those at the federal level. Employers must adhere to the stricter of federal or state child labor laws.

FLSA child labor provisions also protect educational opportunities of minors. The provisions include restrictions on hours of work for minors under age 16 and lists of hazardous occupations to perform. These lists, which are established by the U.S. Secretary of Labor, cover both farm and non-farm jobs.

What unemployment benefits are available to U.S. workers?

The U.S. Department of Labor's Unemployment Insurance (UI) programs provide unemployment benefits to eligible workers who lose their jobs through no fault of their own, and meet certain other eligibility requirements. States have the power to determine the person's eligibility and amount of federal and state unemployment benefits received.

Most employers in the private and governmental sectors are subject to paying unemployment tax at both the federal and state level. The Federal Unemployment Tax Act (FUTA) provides payments to employees who have lost their jobs and meet the eligibility requirements. The FUTA tax rate of 6% is applicable to the first \$7,000 paid to each employee. State unemployment tax rates vary.

What are Social Security, Medicare and the Additional Medicare Tax?

Both employers and employees are required to pay Social Security and Medicare taxes, which are also known as Federal Insurance Contributions Act (FICA) taxes. FICA helps fund both Social Security and Medicare programs that provide benefits for retirees, the disabled and children.

The current tax rate for Social Security is 12.4% (6.2% is paid by the employer and 6.2% is paid by the employee). The current rate for Medicare is 2.9% (1.45% is paid by the employer and 1.45% is paid by the employee).



Employment Laws and Regs

The Social Security tax has a wage base limit. This is the maximum wage that's subject to the tax for that year. For earnings in 2021, this base is \$142,800. There's no wage base limit for Medicare tax. All covered wages are subject to Medicare tax.

The Additional Medicare Tax applies to an individual's Medicare wages that exceed a threshold amount based on the taxpayer's filing status. Employers are responsible for withholding 0.9% Additional Medicare Tax on an individual's wages paid in excess of \$200,000 in a calendar year, without regard to filing status. An employer is required to begin withholding Additional Medicare Tax in the pay period in which an employee's wages exceed \$200,000 and continue to withhold it each pay period until the calendar year ends. There's no employer match for the Additional Medicare Tax.

What workers' compensation benefits are available to U.S. workers?

When employees are injured at work or acquire an occupational disease, they're entitled to collect workers' compensation. Each state administers an insurance program that provides workers' compensation benefits. The federal government also provides a separate workers' compensation program for federal employees.

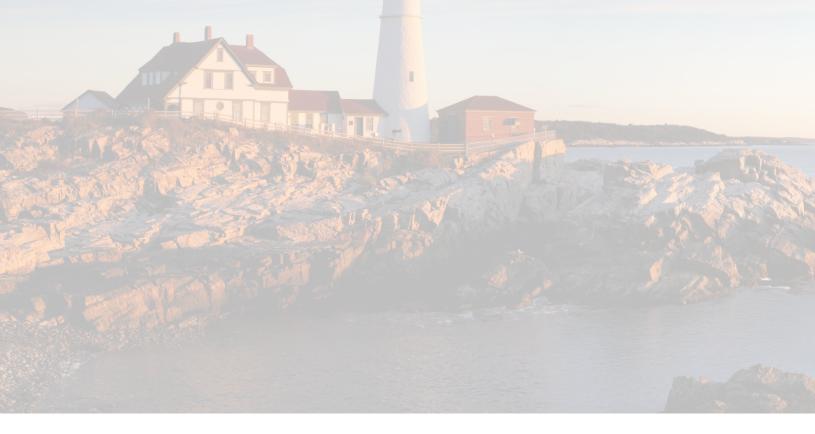
Workers' compensation programs offer:

- Wage replacement benefits,
- Medical treatment.
- Vocational rehabilitation, and
- Other benefits.

Private companies can implement their own independent workers' compensation programs. The U.S. Department of Labor's website provides links to each state's workers' compensation program.



Employment Laws and Regs



Are U.S. employers required to provide health insurance benefits?

Under the Affordable Care Act (ACA), employers with more than 50 full-time equivalent employees (FTE) are required to provide coverage to full-time employees or pay a penalty. The U.S. Department of Labor provides specific instructions on how to calculate FTE.

If an employer with less than 50 FTE chooses to offer health insurance, it must comply with the ACA's requirements for small group plans. Employers that offer health insurance must offer it to all eligible employees within 90 days of their employment start dates.



Right for You?

LET'S TALK

<u>Contact us</u> to set up a meeting to discuss potential business opportunities in the U.S. We can help you develop an investment strategy that works for your unique situation.

ABOUT US

KLR is a premier provider of international tax services to middle market companies and works with foreign-based companies moving to the U.S. market and domestic companies that do business around the world. The KLR Global Tax group is available to assist clients with any tax issues pertaining to either inbound or outbound tax issues, from a corporate perspective and for multinational families. Those issues may include the IRS's Voluntary Disclosure Program, planning for intellectual property transfers, transfer pricing, export incentives, and global restructuring projects.

KLR is one of New England's premier accounting and business advisory firms. With 250+ team members and offices in **Boston**, Lausanne, Newport, Providence, Shanghai and Waltham, KLR provides a wide range of **services** to both individuals and businesses.

Find out why KLR is **so much more than an accounting firm** at **KahnLitwin.com**.

SHARE OUR REPORT





