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Foreign Companies Doing Business in the United States

2018

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01

Forms of Business Organizations

U.S. Corporation

A corporation, having 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 states known for the most liberal corporate law requirements are Delaware and Nevada, 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 or Nevada 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 US 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.

US tax law also imposes a 30% branch profits tax, in addition to US corporate-level income taxes, on a foreign corporation's US 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 US 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 US 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 US that has foreign partners must withhold US 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.

LLC's 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.

02 Taxation

1. Income Taxation

- Under the current law, Federal corporate tax rates on income and net capital gains are on a flat rate of 21%.
- A foreign corporation engaged in business in the US is taxed at regular US corporate tax rates, but only on income that is effectively connected to the US for that business.
- The US source income that is not derived from assets used in the US trade or business of a foreign corporation and that is not effectively connected with a US trade or business or attributable to the foreign corporation's permanent establishment in the US (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.
- Please see the *Wayfair* discussion of State Income Tax filing obligations at the end of the Sales Tax section of this white paper.

2. Sales Taxes

- Sales taxes are imposed at state and local levels, as opposed to the federal level, for products and certain services sold within the US. 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.

Where do states stand when it comes to implementing the "blueprint" from *Wayfair v. South Dakota (the recent Supreme Court case that re-defined nexus for Sales Taxes in the US)*?

As of August 23, 2018, twenty-one states have an economic nexus model in place like South Dakota's regime, which the *Wayfair* suggested was constitutionally valid. Of these, many already have announced plans to start enforcing their laws or will do so as soon as July 1, 2018. Several had made their laws contingent on the high court validating the South Dakota law or eliminating the *Quill* "physical presence" rule, which the high court did in *Wayfair*. Nine of those states aren't members of the Streamlined Sales and Use Tax Agreement (SSUTA), which could make them more vulnerable to litigation, according to language in the *Wayfair* opinion.

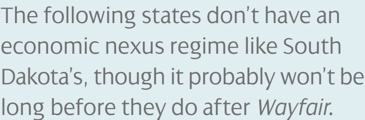
- Nine states so far have issued or plan to issue guidance to sellers on collection duties, and the state's potential "next steps," which could include the implementation of new economic nexus models.
- Eighteen states (excluding those that don't administer a sales tax) don't have a substantial online sales tax regime in place, including an economic nexus one similar to South Dakota's.

Most states with South Dakota "copycat" laws are either moving ahead with laws or already consider them to be in place. Those that were contingent on South Dakota will have to wait for the South Dakota Supreme Court to issue an opinion on remand, which is not available at this time. Below are specifics of those regimes, including effective dates:

- **Alabama** (effective Jan. 1, 2016), $250,000 in in-state sales [Not a member of SSUTA]
- **Connecticut** (effective July 1, 2018), 200 transactions or $250,000 in in-state sales [Not a member of SSUTA]
- **Georgia** (effective Jan. 1, 2019), 200 transactions or $250,000 in in-state sales [Member of SSUTA]
- **Hawaii** (effective July 1, 2018) 200 transactions or $100,000 in in-state sales [Not a member of SSUTA]
- **Illinois** (effective Oct. 1, 2018) 200 transactions or $100,000 in in-state sales [Not a member of SSUTA]
- **Indiana** (effective July 1, 2017) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Iowa** (effective Jan. 1, 2019) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Kentucky** (effective July 1, 2018) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Louisiana** (contingent on *Wayfair* ruling) 200 transactions or $100,000 in in-state sales [Not a member of SSUTA]
- **Maine** (effective Oct. 1, 2017) 200 transactions or $100,000 in in-state sales [Not a member of SSUTA]
- **Minnesota** (contingent on *Wayfair* ruling) No Threshold Set [Member of SSUTA]
- **Mississippi** (effective Dec. 1, 2017) $250,000 in in-state sales [Not a member of SSUTA]
- **North Dakota** (contingent on *Wayfair* ruling) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Oklahoma** (effective July 1, 2018) $10,000 in in-state sales [Member of SSUTA]
- **Pennsylvania** (effective March 1, 2018) $10,000 in in-state sales [Not a member of SSUTA]
- **Rhode Island** (effective Aug. 17, 2017) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **South Dakota** (contingent on state's Supreme Court approval, following high court *Wayfair* decision) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Tennessee** (Currently on hold due to litigation) $500,000 in in-state sales [Not a member of SSUTA]
- **Vermont** (contingent on *Wayfair* ruling, July 1, 2017) 200 transactions or $100,000 in in-state sales [Member of SSUTA]
- **Washington** (effective July 1, 2017) $10,000 in in-state sales [Member of SSUTA]
- **Wyoming** (effective July 1, 2017) 200 transactions or $100,000 in in-state sales [Member of SSUTA]

Many of these states have also enacted other online tax regimes, including:

- Colorado-style notice/reporting regimes that require retailers to alert customers to their tax liabilities;
- marketplace provider provisions that require Amazon-type sellers to collect sales tax on third-party transactions conducted on their platforms; and
- "cookie nexus" regulations, which require online vendors to collect state sales tax if they have property interests in or use in-state apps and "cookies."



The following states don't have an economic nexus regime like South Dakota's, though it probably won't be long before they do after *Wayfair*.

- **Arizona**
- **Arkansas** (SSUTA member)
- **California**
- **Colorado**
- **Florida**
- **Idaho**
- **Kansas** (SSUTA member)
- **Maryland**
- **Massachusetts**
- **Michigan** (SSUTA member)
- **Nebraska** (SSUTA member)
- **Nevada** (SSUTA member)
- **New Jersey** (SSUTA member)
- **New York**
- **North Carolina** (SSUTA member)
- **Ohio** (SSUTA member)
- **South Carolina**
- **Texas**
- **Utah** (SSUTA member)
- **Virginia**
- **West Virginia** (SSUTA member)
- **Wisconsin** (SSUTA member)

While *Wayfair* will have a significant impact on sales and use tax collection obligations, the decision may also impact nexus positions taxpayers have taken with regard to other taxes, most notably, income tax.

In light of the Court's unequivocal statement in *Wayfair* that physical presence is not a necessary element for "substantial nexus," and the Court's review and approval of South Dakota's economic nexus sales tax statute, taxpayers will need to revisit positions they may have taken regarding both sales/use taxes and other taxes and the need for physical presence in order to establish substantial nexus.

For sellers of tangible personal property, Public Law 86-272 (15 USC Section 381-384) remains as the principal limitation on the exercise of state net income tax jurisdiction, including for those states that have enacted factor-presence nexus statutes or that otherwise assert economic presence nexus for corporate income tax purposes. Therefore, as long as such seller's activities in a state are limited to solicitation of orders for sales of tangible personal property (including activities entirely ancillary to solicitation), that are approved or accepted outside of that state, and that are filled by shipment or delivery from a point outside the state, the seller cannot be subject to a state's net income tax. As a result, after *Wayfair*, Public Law 86-272 will take on increased importance for sellers of tangible personal property. Conversely, states should be expected to narrowly interpret the protections of Public Law 86-272 and intensely scrutinize taxpayer claims of protection from net income taxes under the federal law.

3. Social Security 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 $128,400 of salary (for 2018), plus a "Medicare" tax, again payable by employer and employee at 1.45% each of the entire salary with no limitation.

  However, under any of the totalization agreements entered into by the US, foreign nationals will not 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, Workers' Compensation Insurance and State mandated Disability Insurance.

4. Tariff

A tariff is a tax on imports or exports. Money collected under a tariff is called a duty or customs duty. Tariffs are used by governments to generate revenue or to protect domestic industries from competition. There are generally two types of *tariffs*. *Ad Valorem* tariffs are calculated as a fixed percentage of the value of the imported good. When the international price of a good rises or falls, so does the tariff. A *Specific Tariff* is a fixed amount of money that does not vary with the price of the good. In some cases, both the *Ad Valorem* and *Specific Tariffs* are levied on the same product.

Transfer Pricing

The IRS increases its scrutiny on transfer pricing when related US 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 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 US transfer pricing cases. In cases where a treaty country is involved, consult a competent authority on inter-company transactions.

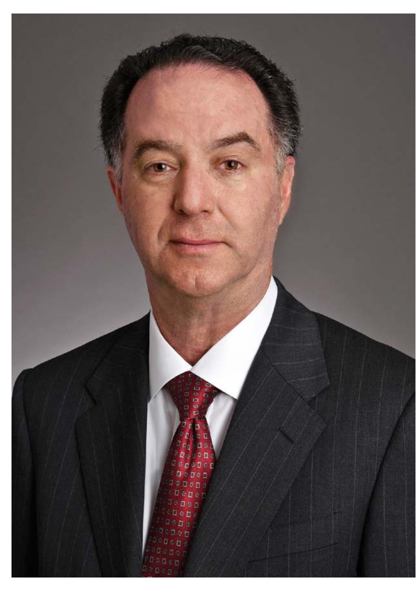
To mitigate controversies in transfer pricing disputes, the IRS encourages using Advanced Pricing Agreements (APA). An APA is a prospective agreement between the IRS and the taxpayer to determine compliance with the arms-length standard. It is expected that when treaty partners are involved, the competent 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.

03 Tax Law Changes for 2018

- Starting in 2018, a business can only write off interest expenses that are equal to 30 percent of its adjusted taxable income. The rules around this can be complicated, though, and there are exceptions. For example, one exception is for small businesses with average annual gross receipts of $25 million or less for the three-tax-year period ending with the prior tax year.
- In the past, if a business recorded an operating loss, it had the option to use the loss to either reduce its income in the past two tax years, or to reduce any future taxable income for the next 20 years. Under the new tax law, Net Operating Losses can only be carried forward, and are limited to 80 percent of taxable income in any given year.

Contact Us

Hoberman & Lesser CPAs, LLP



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Hoberman & Lesser CPAs, LLP
252 West 37th Street
Suite 600E
New York, NY 10018-6636

+1 212 463 0900
+1 212 691 6452
robert@hobermanlesser.com
www.hobermanlesser.com

A member of

Robert Hoberman

MGI Worldwide Key Contact and Managing Partner at Hoberman & Lesser

+1 212 463 0900
robert@hobermanlesser.com

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.

Doing business in the United States