



# Foreign Companies Doing Business in the United States

# 2021



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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 formed at the state level and 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. However, a corporation that is formed in one state to take advantage of those rules and does business in another state must register and file tax returns in every state that it does business.

### 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 people or entities 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.

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.



# 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 Tax

- 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 4.875% and New York State is 4% for a combined total of 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 September 24, 2020, forty-four states and the District of Columbia have an economic nexus model in place like South Dakota's regime, which the *Wayfair* Supreme Court decision suggested was constitutionally valid. *Twenty-one* of those states and the District of Columbia are not 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.

Below are specifics of those regimes, including effective dates:

- Alabama (effective Oct. 1, 2019), \$250,000 in in-state sales [Not a member of SSUTA]
- Alaska (effective date varies by district) 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Arizona (effective Oct. 1, 2019), \$200,000 in in-state sales [Not a member of SSUTA]
- Arkansas (effective Jul. 1, 2019), 200 transactions or \$100,000 in in-state sales [Member of SUTA]
- California (effective Apr 1, 2019) \$500,000 in in-state sales [Not a member of SSUTA]
- Colorado (effective Dec. 1, 2018), \$100,000 in in-state sales [Not a member of SSUTA]
- Connecticut (effective July 1, 2019), 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- District of Columbia (effective Jan. 1, 2019), 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Florida (effective July 1, 2020), 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Georgia (effective Jan. 1, 2020), 200 transactions or \$100,000 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]
- Idaho (effective June 1, 2019), \$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 Oct. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Iowa (effective Jan. 1, 2019) \$100,000 in in-state sales [Member of SSUTA]
- Kansas (effective Oct. 1, 2019), \$100,000 in in-state sales [Member of SSUTA]
- Kentucky (effective Oct. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Louisiana (effective July 1, 2020) 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Maine (effective July 1, 2018) 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Maryland (effective July 1, 2018), 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]





Continued..

- Massachusetts (effective Oct. 1, 2019), \$100,000 in in-state sales [Not a member of SSUTA]
- Michigan (effective Oct. 1, 2018), 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Minnesota (effective Oct. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Mississippi (effective Dec. 1, 2017) \$250,000 in in-state sales [Not a member of SSUTA]
- Nebraska (effective Apr. 1, 2019) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Nevada (effective Nov. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- New Jersey (effective Nov. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- New Mexico (effective July 1, 2019) \$100,000 in in-state sales [Not a member of SSUTA]
- New York (effective June 24, 2019) 100 transactions or \$500,000 in in-state sales [Not a member of SSUTA]
- North Dakota (Jan. 1, 2019) \$100,000 in in-state sales [Member of SSUTA]
- Ohio (effective Aug. 1, 2019) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Oklahoma (effective Nov. 1, 2019) \$100,000 in in-state sales [Member of SSUTA]
- Pennsylvania (effective Jul. 1, 2019) \$100,000 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 Carolina (effective Nov. 1, 2018) 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- South Dakota (Nov. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Tennessee (Oct. 1, 2020) \$100,000 in in-state sales [Associate member of SSUTA]
- Texas (effective Oct. 1, 2019) \$500,000 in in-state sales [Not a member of SSUTA]
- Utah (effective Jan. 1, 2019) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Vermont (July 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Virginia (effective July 1, 2019) 200 transactions or \$100,000 in in-state sales [Not a member of SSUTA]
- Washington (effective Mar. 1, 2019) \$100,000 in in-state sales [Member of SSUTA]
- West Virginia (effective Jan. 1, 2019) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Wisconsin (effective Oct. 1, 2018) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]
- Wyoming (effective Feb. 1, 2019) 200 transactions or \$100,000 in in-state sales [Member of SSUTA]

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

- 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."

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 \$137,700 of salary (for 2020), 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 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.





## 5. Transfer Pricing

The IRS increases its scrutiny on transfer pricing when related to 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 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 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.



# Contact Us

## Hoberman & Lesser CPAs, LLP


### Firm Overview

Hoberman & Lesser is a member of MGI North America, part of MGI Worldwide CPAAI, a top 20 ranked international audit, tax, accounting and consulting network with almost 10,000 professionals in some 460 locations around the world.

Accounting firms, like people, have distinctive personalities. Perhaps the attribute that best describes Hoberman & Lesser (HL) is our ability to go beyond the routine to provide an extra dimension in quality, effort and service.

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.

HL's services are performed in accordance with the professional and ethical pronouncements of the American Institute of Certified Public Accountants (AICPA). Our firm is highly regarded by banks, investment bankers and lending institutions.

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MGI Worldwide Key Contact and Managing Partner Robert Hoberman joined the firm in 1981, became a partner four years later and now serves as the firm's managing partner. He 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 both 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 CCF). He currently serves as a board member for the Lester M. Entin Foundation.

Robert regularly authors articles that are published in Rapaport Magazine to address timely tax and financial issues related to the jewelry industry.