FOREIGN COMPANIES DOING BUSINESS IN THE UNITED STATES

HOBERMAN & LESSER

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2024

FORMS OF BUSINESS ORGANIZATION

U.S. CORPORATION

A corporation, having limited personal liability, is the form of organization most common in the U.S. Many of the procedures and requirements are similar to those relating to the formation of companies in the UK, except that a U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S. and state governments have the concept of taxable income "effectively connected" with a U.S. source, and if a foreign corporation has effectively connected income, then the foreign corporation will be subject to U.S. tax on such income the same way as a U.S. 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-U.S. resident will be subject to U.S. 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.

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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 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 the allocation of profits and losses, as well as distributions. Any partnership engaged in a trade or business in the U.S. 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 U.S. The LLC is usually defined from a U.S. legal perspective as a company - statutorily authorized in certain U.S. 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 U.S. 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 U.S. 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.

TAXATION AND FORMS

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 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 U.S. (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 U.S. 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.*

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 U.S. 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 U.S.)?

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.

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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 U.S.)?

As of August 1, 2023, 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.

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

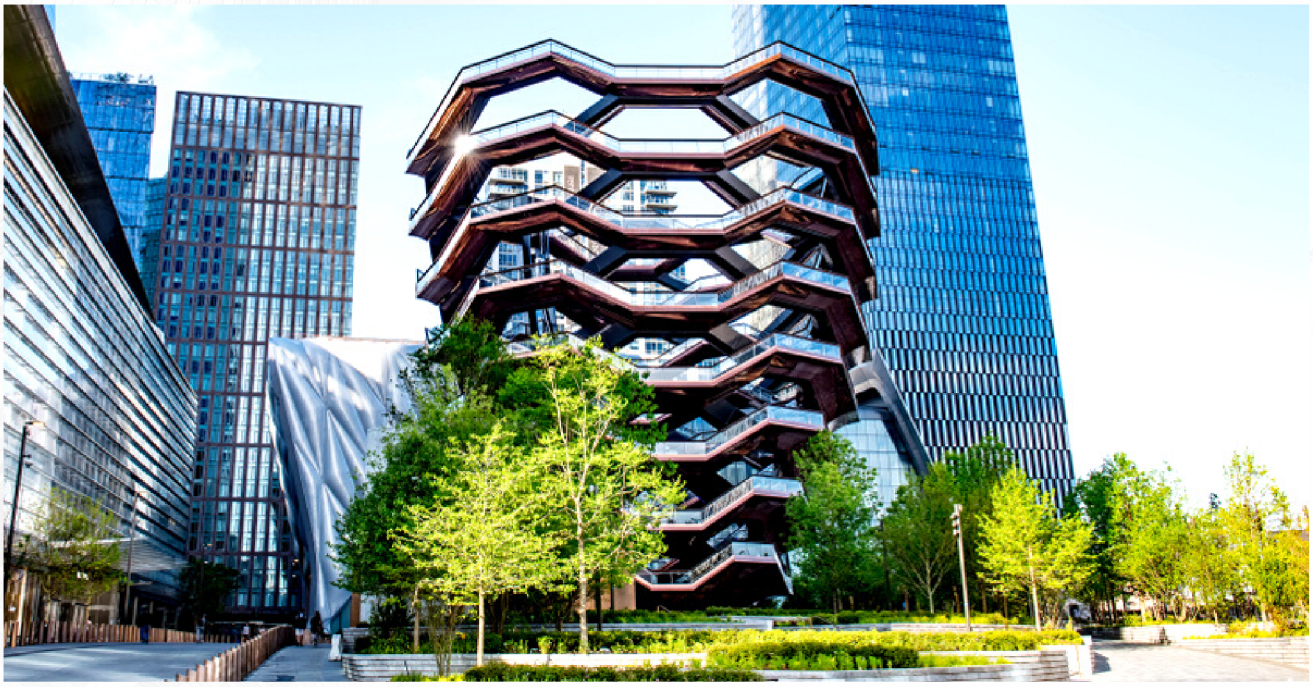
- notice/reporting regimes that require retailers to alert customers to their tax liabilities
- marketplace provider provisions that require Amazon-type sellers to collect sales tax on third-party transactions conducted on their platforms
- "cookie nexus" regulations, which require online vendors to 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 the 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 federal law.



SOCIAL SECURITY TAXES

Social security taxes will need to be paid by resident individuals working within the U.S. by both employer and employee at the rate of 6.2% each on the first $160,200 of salary (for 2023), 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 U.S., foreign nationals will not pay social security taxes in the U.S. if they are transferred temporarily to the U.S. 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 U.S., provided that ultimately the foreign national has contributed to the social security system for at least 18 months in the U.S.

There are also other types of payroll taxes such as Federal Unemployment Insurance, State Unemployment Insurance, Workers' Compensation Insurance and State mandated Disability Insurance.

FORM W-8BEN

When a foreign person receives certain types of income from the U.S., the U.S. government usually takes out 30% of that income as a withholding tax, unless the person provides valid documentation to prove their beneficial status. This valid documentation is the Form W-8BEN, which foreign individuals must provide to the withholding agent (a person or entity that has custody of the amount subject to withholding) in the U.S.

Form W-8BEN Is Used To Establish:

- Whether the person is a U.S. resident for tax purposes.
- Whether the person is a foreign resident and the beneficial owner of the income who qualifies for a reduced withholding rate or is exempt from withholding, based on a tax treaty between their home country and the U.S.

The withholding agent, which can be a U.S. or foreign individual or entity, is responsible for withholding the tax from the income paid to the foreign person unless the person is a U.S. resident or a foreign beneficial owner who is eligible for an exemption.

If a foreign person doesn't provide Form W-8BEN, the withholding agent will typically withhold 30% of the income as required by law or, in some cases, at the backup withholding rate. It's essential for foreign individuals to provide the form to ensure the correct withholding amount is applied to their income.

FORM 5471

Some U.S. taxpayers must file a Form 5471 if they have connections to certain foreign corporations. The form may be required if:

- You own 10% or more of a foreign corporations' voting power or shares.
- You're an officer or director of a foreign corporation and own 10% or more of the shares.
- You buy or sell stock in a foreign corporation that meets the 10% ownership requirement.
- You controlled a foreign corporation with 50% or more ownership of the voting power or total value of stock at any time during the tax year.
- You own 10% or more of a Controlled Foreign Corporation (CFC), which is a foreign company with U.S. shareholders who collectively have control (50% or more ownership) over it.

If the form is not filed when required, you can be subject to penalty $10,000 for each foreign corporation. However, in a recent case (Alon Farhy v. the Commissioner of the Internal Revenue Service), the U.S. Tax Court ruled that the IRS doesn't have the authority to impose the penalty for not filing Form 5471. But it's important to note that taxpayers who fail to comply with the obligation to file the form may still be subject to penalty, although it's now more difficult for the IRS to file a petition before court. The Tax Court's ruling can still be appealed, so it's not the final decision.

FORM 5472

Form 5472 may need to be filed by some U.S. corporations or foreign corporations doing business in the U.S. The form may be required if:

- A foreign entity owns 25% or more of a U.S. corporation.
- A foreign corporation is engaged in trade or business in the U.S.

This form is used to report any transactions that the company has with foreign-related parties. These transactions include monetary transactions, like loans or interest payments, or non-monetary exchanges, like transferring properties or providing services between the company and the foreign-related party.

Form 5472 is not required if the company doesn't have reportable transactions with foreign-related parties, or if certain limited exceptions apply.

If the form is not filed when required, the company can be subject to penalty $25,000.

EMPLOYER IDENTIFICATION NUMBER (EIN)

Nearly every form of business organization that is effectively connected to the U.S.-including sole proprietorships, partnerships, corporations, LLCs, nonprofits, estates, and trusts—needs an Employer Identification Number (EIN).

Your Employer Identification Number (EIN) is your federal tax ID. You need it to pay federal taxes, hire employees, open a bank account, apply for business licenses and permits, file tax returns for employment, excise, or alcohol, tobacco, and firearms and/or withhold taxes on income, other than wages, paid to a non-resident alien.

Although every business that has employees needs an EIN, the “Employer” label in “EIN” doesn’t mean a business has to have employees to need an EIN.

For example, corporations, trusts, and partnerships need an EIN whether or not they have employees. Much like a Social Security number, the government uses your EIN (also known as a federal business tax ID number) to identify your business. Every corporation needs an EIN for taxes, even if you don’t have employees. Additionally, banks, credit card companies, and vendors will likely demand your EIN before transactions.

It's free to apply for an EIN, and you should do it right after you register your business.

The need for a state tax ID number ties directly to whether your business must pay state taxes. Most states allow you to use your Federal EIN for income taxes and sales taxes but require a separate state tax ID number for certain payroll taxes. To know whether you need a state tax ID, research and understand your state's laws regarding income taxes, sales taxes, and employment taxes, the three most common forms of state taxes for small businesses. The process to get a state tax ID number is similar to getting a federal tax ID number, but it will vary by state. You'll have to check with your state government for specific steps.

TRANSFER PRICING

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

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FIRM OVERVIEW

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.

Hoberman & Lesser is a member of MGI Worldwide, a Top 20 international accounting network of independent audit, tax, and accounting firms, which combines the expertise of more than 9,000 professionals in over 400 locations throughout North America and around the world.

Our membership enables us to provide our clients national and international service, resources, and support. Through MGI Worldwide, Hoberman & Lesser has established relationships and connections with professionals who we know and trust in all corners of the globe. With our MGI colleagues, we can provide a complete service offering and assist you make your national or international business operations a success. MGI Worldwide is a quality controlled network and, like all independent member firms, Hoberman & Lesser is subject to review of our quality assurance systems and procedures that comply with international standards.

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Robert Hoberman joined the firm in 1981, became a partner four years later and now serves as the firm's managing partner and MGI Worldwide Key Contact. 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 CCFA). 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.