



PrimeGlobal

*An Association of
Independent Accounting Firms*

DOING BUSINESS IN UNITED STATES OF AMERICA



CLAYTON  **McKERVEY**

COMPANY FORMATION IN THE USA

MAIN FORMS OF COMPANY/BUSINESS IN THE UNITED STATES OF AMERICA

- The principal forms of doing business in the U.S. are the corporation, limited liability company (LLC), partnership, limited partnership, and branch.
- The LLC, partnership, and branch are tax transparent, although the LLC is eligible to elect its entity status under the "check the box" rules. The corporate structure is treated as a separate entity for legal and tax purposes and is the most common for foreign investors.
- The "check the box" election is an entity classification election made for tax purposes only; to elect corporation, partnership, or disregarded entity status for eligible entities. There are default rules if an election is not made.
- The LLC is a relatively new state structure which provides limited liability for owners and provides flexibility in electing its tax treatment and can be used by foreign investors.

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

- Determine if level of activities give rise to a permanent establishment. Non-residents are only subject to business income tax on income effectively connected with a U.S. trade or business. Residents are taxed on their worldwide income.
- Non-residents are always subject to non-business income tax on U.S. source payments ("FDAP") such as interest, dividends, rents, and royalties, at a rate of 30% and is reduced or eliminated by the related treaty.
- A foreign partner in a U.S. partnership is considered engaged in a U.S. trade or business and is subject to withholding on the partner's share of effectively connected income at the highest corporate rate of 35%.
- There is generally no tax advantage for a foreign corporation to operate thru a U.S. partnership or branch due to the branch profits tax which imposes a 30% tax on adjusted current earnings and profits (or "dividend equivalent amount").
- Thin capitalization rules apply to limit interest deduction on payments to non-U.S. related entities and may re-characterize such payments as dividends. These rules apply if the debt to equity ratio exceeds 1:5 and separate calculations are required to determine deductible interest amounts. Disallowed interest may be deductible in future years.
- There are no federal tax incentives for locating in a given location. However, the U.S. does have a number of federal tax credits and deductions meant to operate as incentives such as Research and Development (R&D credits) and Energy credits, manufacturing deductions and accelerated depreciation. State incentives and credits can be negotiated separately at the state and local level.
- Taxes in the U.S. are levied by all levels of government; federal, state, and local. There are no federal sales taxes or value added tax although the federal government does assess excise tax at the wholesale level on certain commodities. Most states and local governments generally levy sales tax on the final consumer purchase. Graduated rates of federal business income tax range from 15% to 35% of net taxable income. State tax rates vary widely from 3%-11% of taxable income.

LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

- Many companies are formed in Delaware which has a history of favorable corporate statutes.
- A firm may organize under the laws of any one of the states and would be deemed domestic in that state. To qualify to do business outside the state of incorporation may require additional incorporation or registration steps. It is very common for companies to operate in multiple states.
- There is no minimum capital or management nationality requirement although specifics are governed by state law.
- Business licenses may be required by local or state authorities.

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

In considering establishing a business in the U.S. there are large diverse cultural differences between states and cities.

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

There are no requirements for statutory audits in the U.S.

PERMANENT ESTABLISHMENT IN THE USA: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

Nonresident taxpayers are liable for corporate income tax on income attributable to a U.S. PE. The definition of a PE is not incorporated into the internal revenue code but is defined by the related tax treaty.

Per the model treaty, Art 5 (which is modified treaty to treaty) a PE includes:

- a fixed place of business through which business of an enterprise is carried on
- especially a place of management, branch, office, factory or workshop
- a building site or construction or installation project...if it lasts longer than twelve months
- the term PE shall be deemed not to include; the use of facilities solely for the purpose of storage, display or delivery of goods belonging to the enterprise
- the term shall include agents acting on behalf of the enterprise that habitually exercises that authority to conclude contracts that are binding on the enterprise
- an enterprise shall not be deemed to have a PE if it carries business through a broker, general commission agent or any other agent of independent status, provided they are acting in the ordinary course of their business as independent agent.

Special care should be taken for services carried out longer than six months.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

A branch is part of a corporation and not a separate legal entity. A foreign corporation may establish a branch and commence business at any time as long as local state laws are adhered to.

States are not required to follow the tax treaties.

A subsidiary set up as a U.S. corporation is a separate legal entity created under the laws of one of the states. Note that a limited liability company is eligible to be treated as a corporation for tax purposes under the "check the box" rules.

TAX AND ACCOUNTING OBLIGATIONS

A U.S. branch of a foreign corporation is subject to tax on net income that is effectively connected to the U.S. business. The U.S. also maintains a branch profits tax (BPT) of 30% of the "dividend equivalent amount". The BPT can be reduced or eliminated through tax treaties.

A subsidiary set up as a U.S. corporation is taxed on its worldwide income. Foreign income of these companies is taxed at regular corporate rates, however, to avoid double taxation on income earned outside the U.S., a foreign tax credit is available for foreign taxes paid, up to the amount of U.S. tax paid.

REGISTRATION FORMALITIES

Advice should be obtained from legal counsel regarding the registration requirements of a branch as these vary by state or advice on the use of an limited liability company to obtain liability protection.

There is no statutory audit requirement; an audit may be required by creditors, customers or as part of the worldwide reporting. Audit reports are generally based on U.S. GAAP.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

One registered, operations of a branch are similar to any other form of business, although the specific tax obligations may be different.

HOW TO HIRE MY FIRST EMPLOYEE IN THE USA

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

Before hiring your first employee, you need to get an employment identification number (EIN) from the U.S. Internal Revenue Service. The EIN is often referred to as an Employer Tax ID or as Form SS-4. The EIN is necessary for reporting taxes and other documents to the IRS. In addition, the EIN is necessary when reporting information about your employees to state agencies. Apply for EIN online at IRS.gov.

1) *According to the IRS, you must keep records of employment taxes for at least four years.* Below are three types of withholding taxes you need for your business:

- **Federal Income Tax Withholding** - Every U.S. employee must provide an employer with a signed withholding exemption certificate (Form W-4) on or before the date of employment. The employer must then submit Form W-4 to the IRS.
- **Federal Wage and Tax Statement** - Every year, employers must report to the federal government wages paid and taxes withheld for each employee. This report is filed using Form W-2, wage and tax statement. Employers must complete a W-2 form for each employee who they pay a salary, wage or other compensation. Employers must send Copy A of W-2 forms to the Social Security Administration by the last day of February to report wages and taxes of your employees for the previous calendar year. In addition, employers should send copies of W-2 forms to their employees by Jan. 31 of the year following the reporting period.
- **State Taxes** - Depending on the state where your employees are located, you may be required to withhold state income taxes. Most companies use a payroll service to handle the tax reporting and filing.

2) *Register with Your State's New Hire Reporting Program* - All employers are required to report newly hired and re-hired employees to a state directory within 20 days of their hire or rehire date in the state in which you have employees working. Many states have a centralized, online registration function which will allow the company to complete one application for all applicable taxes.

3) *Obtain Workers' Compensation Insurance* - All businesses with employees are required to carry workers' compensation insurance coverage through a commercial carrier, on a self-insured basis or through their state's Workers' Compensation Insurance

4) *Post Required Notices* - Employers are required to display certain posters in the workplace that inform employees of their rights and employer responsibilities under labor laws.

5) *File Your Taxes* - Generally, employers who pay wages subject to income tax withholding, Social Security and Medicare taxes must file IRS Form 941, Employer's Quarterly Federal Tax Return. For more information, visit IRS.gov.

7) *Complying with standards for employee rights in regards to equal opportunity and fair labor standards is a requirement.* Following statutes and regulations for minimum wage, overtime, required benefits and child labor will help you avoid error and a lawsuit. See the Department of Labor's Employment Law Guide for up-to-date information on these statutes and regulations. Also, visit the websites for Equal Employment Opportunity Commission and Fair Labor Standards Act (FLSA).

8) *A job description should be created for the employee.* Each new title should have a separate job description. This job description should include duties/tasks of the position, education and/or experience requirements, FLSA Status - exempt or non-exempt, hours required, skills required, physical activities required. Job description

should be signed off on by employee. As their title changes, a new job description should be signed for the new title.

9) A "Policy and Procedures Manual" or "Employee Handbook" should be established. This will cover many topics such as the companies Mission Statement and Code of Ethics as well as required notices such as EEO Notice, FLSA Notice, FMLA Notice, CHIP Notice etc. It will also explain subjects such as office hours, compensation and payroll procedures, health insurance and benefits, safety policies and procedures, leave and attendance policy and benefits (sick time vacation time holidays etc.), Anti-Harassment Policy, Smoking Policy, Dress Code, Computer and Information Technology Policy, Drug-Free Workplace Policy etc. Employees should sign off on a form stating that 1) they received a handbook or 2) they understand that the handbook is available to them on line or through company intranet.

10) If company is granted Federal Government Contracts then new employee must be entered in the USCIS website "E-Verify" (www.uscis.gov). To confirm legal employment status of employee.

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

The Employment Contract can be broken down in two (2) parts 1) The employment letter and 2) The Employment Agreement. The employment letter should outline specifically the position title, salary, bonuses, (relocation bonus, sign-on bonus etc.), leave benefits, start date, office location, required work hours, prerequisites to hire such as successful completion of drug testing and/or background check, date orientation will take place, instructions on what to do with new hire forms etc.

The Employment Agreement will cover specific information that helps the employer if there is ever an employee disagreement. Employee salary and start date are noted in the Employment Agreement. If applicable, these are topics that can be covered in the Agreement - professional standards, post employment non-complete/solicitation requirements, confidentiality agreements, employment mediation procedures, payback clauses etc. Both the employment letter and the employment agreement should be signed by the employer and employee.

CAN SOMEBODY DO BUSINESS FOR ME AND NOT BE AN EMPLOYEE?

The IRS has published the 20 factors that its auditors use as guidelines in resolving the employee-or-contractor/consultant issue. In short, it depends on the type of work they are doing and the length of time. If they have their own office and supplies and you are just using them as a "Consultant" then I would suggest setting up a "Consultant Agreement" with them. This is similar to the "Employment Agreement" but describes topics such as - Scope of Services, Time frame/Date the Agreement is good through, location of services, terms and conditions of payment, confidentiality agreement, tax provision stating that they are responsible for all federal, state and local taxes. It should also note who the contact is within the company that is responsible for the assigned work and time frame for final product. This agreement should be signed by both the employee and employer.

If it is determined that the position is truly a consulting/contractor position, an IRS Form 1099-Misc. will need to be filled out by the employer. This form reports income to the consultant of more than \$600 in one year. The consultant will then use this to file their yearly taxes. The consultant is responsible for all federal, state and local taxes on their income. The consultant should provide Form W-9 (Tax Payer Identification Number Certification) to the employer.

HOW TO READ FINANCIAL STATEMENTS IN THE USA

The basic financial statements presentation in the U.S. consists of the following:

- The Balance Sheet
- The Statement of Cash Flows
- The Income Statement (Statement of Comprehensive Income)
- The notes to the financial statements
- The Statement of Retained Earnings and Stockholders' Equity

Sample Company
BALANCE SHEET
 As of December 31, 201X

ASSETS

CURRENT ASSETS:

Cash and cash equivalents
 Investments
 Accounts receivable
 Inventory
 Employee advances
 Prepaid insurance and other expenses
 Current portion of loans receivable
 Deferred tax asset, current
 Other current assets
 Total Current Assets

\$

PROPERTY AND EQUIPMENT:

Land
 Buildings and improvements
 Furniture and fixtures
 Office equipment
 Machinery and equipment
 Autos and trucks
 Software
 Leasehold improvements

\$

Less accumulated depreciation

\$

OTHER ASSETS:

Loans receivable, net of current portion
 Deposits
 Cash surrender value of life insurance
 Other assets
 Deferred tax asset, noncurrent
 Goodwill

\$

TOTAL ASSETS

=====

\$

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Line of credit	
Current portion of long-term debt	
Current portion of capital lease obligations	
Accounts payable	
Accrued compensation	
Deferred revenue	
Related party payable	
Deferred tax liability, current	
Other current liabilities	
Total Current Liabilities	\$ _____

LONG TERM LIABILITIES:

Long-term debt, less current portion
Capital lease obligations, less current portion
Deferred tax liability, non-current

STOCKHOLDERS' EQUITY:

Common stock, \$XX par value, # shares authorized, # shares issued, # of shares outstanding	
Additional paid-in capital	
Retained earnings	
Accumulated other comprehensive income (loss)	_____
Total Retained Earnings and Accumulated Other Comprehensive Income (Loss)	_____
Treasure stock, # of shares, at cost	_____
Total Stockholders' Equity	\$ _____

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY \$ _____

INCOME STATEMENT
December 31, 201X

SALES	
COSTS OF SALES	
GROSS PROFIT	_____
	\$
OPERATING EXPENSES	
Advertising	
Bad debt	
Bonuses	
Contract fees	
Depreciation and amortization	
Dues and subscriptions	
Employee benefits	
Equipment rental	
Insurance	
Materials and supplies	
Meals and entertainment	
Miscellaneous	
Office expenses	
Payroll and payroll taxes	
Professional fees	
Property and other taxes	
Repairs and maintenance	
Utilities	
Total Operating Expenses	_____
	\$
OPERATING INCOME	_____
	\$
OTHER INCOME (EXPENSE)	
Interest and dividend income	
Rental and other income	
Interest expense	
Realized/unrealized gain (loss) on investments	
Gain (loss) on disposal of property and equipment	
Net Other Income (Expense)	_____
	\$
INCOME TAXES EXPENSE (BENEFIT)	_____
NET INCOME (LOSS)	_____
	\$
OTHER COMPREHENSIVE INCOME (LOSS)	
Net unrealized investment gain (loss), net of tax	
Foreign currency translation, net of tax	
Total other comprehensive income (loss)	_____
TOTAL COMPREHENSIVE INCOME (LOSS)	_____
	\$

STATEMENT OF RETAINED EARNING AND STOCKHOLDERS' EQUITY
December 31, 201X

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasur y Stock	Total
Balance at December 31, 201X						
Net Income (Loss)						
Issuance of common stock						
Dividends						
Total Comprehensive income (loss)						
Treasury Stock Purchase						
Balance at December 31, 201X	\$	\$	\$		\$	\$

STATEMENT OF CASH FLOWS
December 31, 201X

CASH FLOWS FROM OPERATING ACTIVITIES

Net income (loss)
Adjustments to reconcile net income(loss) to net cash provided by (used in) operating activities:
Depreciation and amortization
Provision for doubtful accounts
Unrealized (gain) loss on investments
(Gain) loss on sale of property and equipment
Foreign currency translation adjustment
Deferred taxes on income
(Increase) decrease in cash surrender value of life insurance
(Increase) decrease in assets:
 Accounts receivable
 Inventory
 Investments (classified as trading)
 Employee advances
 Prepaid insurance and other expenses
 Other current assets
Increase (decrease) in liabilities:
 Accounts payable
 Accrued expenses
 Deferred revenue
 Related party payable
 Other current liabilities

NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES

\$

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of investments
Proceeds from sale of investments
Purchase of property and equipment
Proceeds from sale of property and equipment
Collections on loans receivable

NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES

\$

CASH FLOWS FROM FINANCING ACTIVITIES

Net borrowings on (repayment of) line of credit
Issuance of common stock
Dividends paid
Payment on capital lease obligations
Proceeds from borrowings on long-term debt
Payments made on long-term debt

NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES

\$

NET INCREASE (DECREASE) IN CASH

\$

CASH AT BEGINNING OF YEAR

CASH AT END OF YEAR

\$

STATEMENT OF CASH FLOWS (CONTINUED)
December 31, 201X

SUPPLEMENTAL DISCLOSURE OF CASH FLOW DATA

Cash paid for interest during the year	\$
Cash paid for income taxes during the year	\$

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES

During the year ended December 31, 201X, the following noncash investing and financing activities were incurred:

Redeemed shareholder note for treasury stock	\$
Acquisition of equipment through financing	\$
Sale of equipment on installment loan basis	\$