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An Inbound Guide to Doing Business in the United States

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If you own a business in a foreign country, are you thinking of expanding and entering the U.S. market?

In choosing to conduct business in the United States, businesses based in other countries should keep in mind that U.S. business entities are formed under the laws of state governments, not the U.S. (Federal) Government. The choice of the type of legal structure will be dependent on a number of factors such as activities that extend along the continuum, included those associated with a representative office, sales office, purchasing or procurement office, manufacturing branch, full-fledged sales or manufacturing operation, etc. Essentially, if your intent is to sell goods into the U.S.—whether online or through U.S. partners such as a wholesaler—you may not have to form an entity in the U.S. to do so.

There are number of ways in which your company can structure business activities in the U.S., depending upon your business model.

What is important is choosing a structure that is compatible with the way the group anticipates operating in the U.S.; do not do anything purely for tax reasons. However, if you plan to have a physical presence in the U.S. (such as an office or employees) you should be aware of the legal and tax ramifications of forming a business entity, whether as a corporation or Limited Liability Company (LLC).

The U.S. system governing the taxation of income earned by non-U.S. persons draws a fundamental distinction in the U.S. tax treatment of income that has a nexus within the U.S., based on the level and extent of the non-U.S. person's U.S. presence. In other words, a U.S. individual or corporation is taxed on its worldwide income, whereas a non-U.S. person generally is taxed in the United States only on income derived from its U.S. investments or business activities.

Operating as a Subsidiary

From a U.S. tax perspective, operating a U.S. business as a branch or as a subsidiary can have important implications for the foreign owner. This determination must be made based on a variety of factors, including the level of U.S. presence the business operations will undergo. If a foreign company operates without any presence in the United States, it nevertheless must be concerned that its activities may constitute a “U.S. trade or business,” or, in the income tax treaty context, a U.S. “permanent establishment” (PE).

Foreign persons are taxed on effectively connected U.S. income if they are engaged in business in the United States.

All income that is effectively connected with that business is taxed, whether the income is from U.S. sources or from foreign sources. A foreign person having no PE is not taxed on sales of goods to a U.S. purchaser, even if the income is derived from U.S. sources, unless that foreign person is considered to be engaged in business in the United States. Thus, business activity is the only jurisdictional basis upon which the United States taxes the sale of taxable personal property by a foreign person.

U.S. individuals, U.S. corporations (and their foreign branches) must pay U.S. federal, state and local income tax on their worldwide income. By contrast, foreign corporations and their U.S. branches and partnerships are subject to U.S. tax only on their income that is effectively connected to a U.S. trade or business (ECI) or income that is fixed, determinable, annual or periodic (FDAP).

If a foreign company decides to have a presence in the United States, it must consider the type of presence it will establish.

To the extent the foreign parent's activities fall closer to the minimal degree of presence, operating in branch form may be appropriate; where the activities fall closer to the high degree of presence, there may be more reasons to operate as a U.S. corporate subsidiary. Note that any of the activities can create a taxable presence for state tax purposes, without regard to the federal distinctions.

U.S. federal tax compliance requirements differ, depending upon what form is chosen for investing in the United States. Foreign corporations that operate in the United States in branch form are required to file an income tax return as a foreign corporation. To the extent that a foreign corporation is engaged in a U.S. trade or business, it must pay tax on income attributable to the trade or business. If a corporate form is chosen, the U.S. Corporation itself must file the U.S. tax return and pay tax on its taxable income. If a partnership form is chosen, the foreign partners are treated and taxed as if they were engaged in a U.S. trade or business and must comply with the appropriate filing requirements, in addition to the partnership's filing requirements.

Under U.S. tax law, a partnership is not subject to tax, but instead its partners are individually subject to tax on their share of the partnership's income.

As a result, when a partnership is engaged in a U.S. trade or business, its foreign partners are treated and taxed as if they, themselves, were engaged in a U.S. trade or business. The partner is subject to comparable tax ramifications as the owner of a branch. However, the existence of a U.S. “Blocker” company will prevent the foreign company from being treated as engaged in a U.S. business. A U.S. Blocker Corporation ‘blocks’ the U.S. business from flowing up to the foreign company; hence, the U.S. Corporation, not the foreign company, becomes subject to the tax obligations.

A U.S. branch is an extension in the United States of its foreign corporate owner. A branch is taxed as a division of its parent and is not a legal entity subject to entity-level tax in the United States. When a foreign company establishes a U.S. branch, there is no bright line test to determine whether and when the branch conducts a U.S. trade or business within the U.S. This determination must be made based upon all of the facts and circumstances surrounding the business. The branch profits tax is a branch-level tax on the repatriation of earnings, in the form of dividends, from a foreign corporation's branch in the United States to the home office in the foreign country; It is a tax imposed only on foreign corporations who have effectively connected earnings and profits and this tax is imposed in addition to any U.S. income tax paid by a foreign corporation.

A foreign company's U.S. business operations may evolve and cause the company to reevaluate the business form through which it conducts its activities in the United States. For example, a U.S. office of a foreign company that is expanding in the United States may begin to engage in manufacturing in the U.S., and may hire a larger sales force to sell the products in the U.S. market. Depending upon the degree of the U.S. presence, it may prove practical and beneficial to establish a U.S. subsidiary.

Every business has a unique set of circumstances and attributes that trigger specific tax consequences.

That said, there are certain overarching policies and approaches that can help make the process of doing business in the U.S. smoother. We urge you to consult with one of our international tax advisors before making any significant business or tax-related decisions.