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ESTABLISHING A BUSINESS IN THE UNITED STATES

1. Introduction. The following is a general guide to assist non-US businesses looking to expand business operations into the United States. Although the United States is generally considered a business-friendly jurisdiction, it is also a highly-regulated society. The United States has a three-tiered system of regulation with statutes and regulations existing at the federal, state, and local levels. In addition, certain industries may be subject to additional industry-specific requirements which will need to be considered. The myriad laws and regulations at each level can result in unintended and adverse operational and financial consequences. However, with careful planning prior to commencing business in the United States, many of these hurdles can be overcome or avoided altogether.

The following is a general overview of certain key issues for non-US businesses to consider prior to entering the US marketplace through the formation of a legal entity, a joint venture or an acquisition transaction. It is not intended to be an exhaustive list of the legal requirements to which non-US businesses may be subject, nor does it attempt to provide a comprehensive discussion of each law or issue addressed. Non-US businesses should seek the advice of qualified legal, tax and financial advisors prior to launching US operations or entering into any transaction structured to gain access to the US marketplace.

2. Legal Form of Business. Many non-US businesses elect to form wholly-owned subsidiaries in order to conduct business in the United States. Determining the most appropriate form of business entity or presence within the United States is one of the first items non-US businesses should consider. The choice of entity should be tailored to the specific business operations and goals of the non-US business and should carefully consider the tax consequences, governance, and reporting requirements as well as the exposure to liability associated with the entity or structure.

a. Corporation. The most prevalent form of entity used by non-US businesses to operate within the United States is the corporation which is a separate legal entity owned by shareholders of the corporation. A corporation generally affords its owners limited liability against the debts and obligations of the entity, provided it has been adequately capitalized and has complied with the corporate formalities required under applicable law[1]. Corporations are relatively easy and inexpensive to form and there is a well-established body of corporate law with respect to both tax and legal issues and the corporate form is well understood by banks, investors and others which makes it a convenient vehicle for financing.

In the United States, corporations are formed under the laws of one of the fifty states or the District of Columbia; there is no federal system of corporate law. The corporate laws and requirements of each state are not identical, although they tend to have similar general

[1] Under US law, there are certain liabilities (i.e. product liability, violations of securities laws and failure to pay certain employment taxes) against which a non-US parent may not be insulated even if the corporation has adequate capital and all corporate formalities are observed.

principals. Unlike many European countries, there is no requirement that a business be formed in the jurisdiction in which its principal place of business is located. A corporation may be organized in any state regardless of whether it has business in the state or not, although most businesses incorporate either in the state where their principal operations or office will be located or in a business-friendly jurisdiction. A corporation will be required to register as a foreign corporation in each state in which it is doing business in addition to the state of its incorporation. The majority of US companies opt to incorporate in Delaware because it has flexible corporate governance features and the well-developed corporate law. Delaware is generally considered to be pro-business and pro-management. However, many of the corporate governance features of Delaware corporate law favored by US businesses may be less important or less advantageous to a non-US business forming a US corporation.

The formation of a US corporation is not a taxable event. However, most US corporations are subject to a double taxation system where the corporation pays tax on income at the corporate entity level and stockholders are required to pay tax on dividends received from the corporation. Generally, dividends to a non-US parent will be subject to a 30% withholding tax unless reduced by a tax treaty between the US and the country in which the non-US parent is a resident. Although the US corporation will be required to file US tax returns, simple ownership of stock in a US corporation should not expose the non-US parent/stockholder to a requirement to file a US tax return. Non-US parent/stockholders also need to consider the transfer pricing regulations promulgated by the US Internal Revenue Service (the "IRS") to ensure arms-length transactions between affiliated entities and deter profit-shifting between US and non-US affiliates aimed at tax avoidance. There are also substantial reporting and record-keeping requirements associated with the IRS's transfer pricing regulations.

There are also state and local tax laws that need to be considered, including without limitation, state income tax, franchise taxes imposed by states in which corporations are doing business, sales and use tax requirements, and real and personal property taxes.

b. General Partnership and Limited Partnership. A general partnership is formed when two or more parties associate together, by oral or written agreement, in order to carry on business as co-owners for profit. Although there is some applicable state law, the relationship of the partners is governed principally by the terms of partnership agreement. A general partnership provides for great flexibility in the allocation of economic benefits and the rights and responsibilities amongst the partners. However, partners in a general partnership do not enjoy the limited liability afforded to stockholders in a corporation. Rather, each partner is jointly and severally liable for the partnership's debts and liabilities and a partner's business and personal assets can be sought to satisfy partnership's obligations.

A limited partnership is also a partnership with the relationship of the partners governed primarily by the terms of a partnership agreement; however, the partners are divided into general partners and limited partners. A general partner is responsible for managing the partnership and has joint and several liability for the partnership obligations. In contrast, limited

partners are typically passive investors that have limited liability similar to stockholders in a corporation.

Although there are some exceptions not discussed in this summary, taxation of a general partnership and a limited partnership are generally the same. Under US tax law, the partnership entity itself is not subject to US taxation, although it is required to file an informational return. The partnership is a "flow-through" entity where the tax consequences of the partnership's business operations are passed-through to the individual partners. Each partner must pay taxes on their allocable share of the partnership income regardless of whether any income is actually distributed to the partners. Under US tax law, a non-US partner may be required to file a US tax return if the partnership activities are significant enough to cause the IRS to conclude that the non-US partner is engaging in the conduct of a US trade or business. From a practical standpoint, most non-US businesses want to avoid having to file a US tax return and therefore, this form of entity is not generally recommended for non-US businesses.

Even though partnerships are generally not subject to taxation at the federal level, state and local tax laws will need to be considered, including without limitation, franchise taxes imposed by states in which the partnership is doing business, sales and use tax requirements and real and personal property taxes.

Establishment of a general or limited partnership is often more expensive and will take much longer than the formation of a corporation because the parties will need to prepare a partnership agreement which can involve complex and lengthy negotiations.

Limited Liability Company. A limited liability company or "LLC" is a separate legal entity organized under state law similar to a corporation. In the US, the LLC entity has become increasingly popular because it is a hybrid entity that combines certain advantages of a partnership (i.e. flow-through taxation and flexible capital structure) with the limited liability generally afforded corporate stockholders. LLCs also provide substantial flexibility with respect to management of the LLC. Members of the LLC can actively manage the activities of the LLC or management responsibility can be delegated to one or more managers.

An LLC will typically be taxed as a partnership unless (i) it is a single-member LLC which will be disregarded for US income tax purposes, or (ii) the LLC elects to be taxed as a corporation. Although the LLC structure provides substantial tax advantages for US members, the LLC structure may not result in similar advantages for non-US members. If the LLC is treated as a partnership for US income tax purposes, the non-US member will encounter the same tax consequences discussed above in connection with general and limited partnerships. Similarly, the single member of a single-member LLC disregarded for income tax purposes will be required to report and pay taxes on the LLC's taxable income as if that member conducted the activities of the LLC itself.

LLCs will also need to consider state and local tax issues, including without limitation, state income taxes, franchise taxes imposed by states in which the LLC is doing business, sales and use tax requirements and real and personal property taxes.

Similar to a general or limited partnership, establishment of an LLC will require the development of an operating agreement which can involve complex negotiations and therefore, forming an LLC is usually more expensive and takes much longer than the formation of a corporation.

c. Branch Operation. A non-US business can elect to do business in the US as a branch of the foreign company. Essentially, the US branch is an extension of the foreign business. Establishing a US branch is a simple process. The non-US business must simply register to do business in those states in the United State in which it plans to do business. One of the principal disadvantages to doing business in the US as a branch is that it exposes all of the assets of the non-US business to claims related to the operations of the US branch.

In addition, there are substantial tax disadvantages to branch operations. The operation of a US branch will typically create a taxable presence in the US; the non-US business will need to file a US branch tax return and report its US income. Because the non-US business is directly liable for the taxes of the US branch, there is an increased risk that the books and records of the non-US business could be subject to an audit by the IRS. US tax laws may also impose a "branch profits tax" which is a second level of tax on branch earnings distributed to the non-US business. The withholding tax on US branch profit distributions is usually a 30% tax unless the US has a tax treaty with the resident country of the non-US business that provides for a lower tax rate. The IRS has a tendency to challenge the allocation of profits and losses between the US branch and the home office of the non-US business which creates both financial and operational costs.

3. Joint Ventures. Joint ventures are extremely complex structures and the term "joint venture" does not actually describe a separate legal entity. Rather, a joint venture is generally used to describe a working relationship between two or more parties relating to a specific limited purpose which relationship can take many forms. A joint venture can range from a purely contractual arrangement or strategic alliance to the formation of a separate joint venture entity. If the joint venture results in the formation of a separate legal entity, the non-US business needs to consider all of the legal, operation and tax considerations associated with the entities described above.

The complexity and range of legal issues relating to properly constructed joint ventures includes issues relating to tax, intellectual property, securities, product liability, and antitrust are outside of the scope of this summary. However, the rights and obligations of the venture partners should be documented in a comprehensive joint venture agreement. The following is a list of some of the key issues that should be carefully considered, negotiated and documented when forming a joint venture: (i) allocation of management and control, (ii) obligations to make current and future capital contributions, (ii) requirements relating to current and future technology and intellectual property contributions, (iv) allocation of profits and losses, (v) ownership rights, (vi) distribution rights, (vii) transfer restrictions, (viii) dispute resolution and

deadlocks, (ix) winding down process and/or terminating the joint venture, (x) corporate governance mechanisms and (xi) the scope of the joint venture's business operations.

Any business considering forming a joint venture needs to give careful consideration to selecting the right partner(s) in the joint venture and should conduct substantial due diligence on the partner in advance of finalizing the relationship.

4. Acquiring an Existing US Business. A non-US business may also consider acquiring an existing US business operation rather than setting up a new US entity in order to expand into the US marketplace. Acquisition structures fall generally into one of three categories: (1) asset purchases where a company purchases all or substantially all of the assets of an existing business, (2) stock/equity purchases where a company purchases all of the outstanding shares or equity of the target company, and (3) mergers which involve the combination of two or more entities by operation of law. Similar to joint ventures, a discussion of the complex tax, legal and business issues associated with acquisition structures, the acquisition process and the relevant transaction documents is outside the scope of this summary.

Regardless of the size or complexity of any acquisition transaction, one of the most critical aspects of a successful transaction is the completion of a comprehensive due diligence investigation. The due diligence process provides a company with a chance to request information related to the financial, legal, operational, environmental, tax, regulatory, and compliance aspects of a targeted business. Any issues discovered during the due diligence process can be discussed between the parties and addressed in the definitive legal documents or if an issue is material enough, bring an end to the negotiations. It is important to include legal, financial, environmental and tax advisors in the due diligence process to ensure that all material issues are spotted and that appropriate resolutions can be negotiated when appropriate.

Non-US businesses will also need to review and consider any foreign trade regulation or reporting requirements triggered by the nature or structure of the acquisition transaction. A few of these are discussed briefly below under the section entitled *"Regulation of Foreign Investment and US Reporting Obligations."*

5. Raising Capital. There are a substantial number of types and sources of financing available to businesses within the United States and the capital markets provide methods for raising capital from issuance of securities to traditional and non-conventional debt financing. State and federal laws actually provide for significant flexibility with respect to financing transactions and if third party capital is desired, a non-US business should be able to tailor a suitable financing package to fit its specific needs relating to the establishment, acquisition or maintenance of a US business operation.

The United States does not place unduly burdensome restrictions on the flow of funds into the US or the repatriation of profits; therefore, a wholly-owned subsidiary of a non-US parent will likely be capitalized solely or principally by the non-US parent. However, please see

the brief summary of the reporting requirements on foreign direct investments discussed under the section below entitled *"Regulation of Foreign Investment and US Reporting Requirements."*

In the event a non-US business decides to access the US capital markets, it is import to understand that the sale of stock, debt and other securities is regulated at both the federal and state level. Any offer or sale of securities, which includes both debt and equity, must be registered with the US Securities and Exchange Commission or must be conducted pursuant to available exemptions at both the federal and state level. The fundamental principle behind US securities regulation is full disclosure; the regulations are designed to require disclosure of information relating to a company and its securities which would be material to a reasonable investor when making an investment decision. Compliance with and documenting compliance with state and federal securities laws is highly technical and involves a substantial degree of complexity. Non-US businesses should consult with qualified legal counsel with experience in equity placements and debt financing transactions prior to accessing the capital markets in the US.

6. Regulation of Foreign Investment and U.S. Reporting Requirements. There are a substantial number of US laws and regulations designed to regulate and monitor foreign investments in the United States and commercial transactions involving US and non-US parties or businesses. Failure to comply with these regulations can result in both civil and criminal fines and penalties. The following is a brief summary of some of the federal regulations which may be applicable:

a. Foreign Investment and National Security Act of 2007 / Exon-Florio Notice. Pursuant to the Exon-Florio Amendment, the President of the United States may investigate, suspend or prohibit any merger, acquisition or takeover by or with a non-US person if the President determines that the transaction constitutes a national security threat. The President delegated his investigative authority under the Exon-Florio Amendment to the Committee on Foreign Investments in the US ("CFIUS"), a special interagency committee. The Foreign Investment and National Security Act of 2007 (the "FINSA") further strengthened the authority of the President and CFIUS under the Exon-Florio Amendment by granting CFIUS statutory authority and broadening the scope of investments that CFIUS may elect to review. FINSA also increased the ability of CFIUS to monitor and control activities of foreign investors after conducting a review. Application of the Exon-Florio Amendment is not limited to any particular industry and Congress has indicated that the term "national security" should be construed broadly. FINSA expanded the scope to include any transaction that would result in foreign control of "critical infrastructure" which is also construed broadly. There is no mandatory notice filing, but in the event that the transaction is completed without notice, the President has authority to require the non-US entity to unwind the transaction and divest the acquisition. Therefore, many parties to transactions which may be subject to investigation under the Exon-Florio Amendment or FINSA make voluntary filings disclosing the transaction prior to its consummation. The determination as to whether to initiate an investigation must be made within 30 days of notice of the proposed (or completed) transaction. Should CFIUS decide to

investigate a transaction, there are strict time limits under which CFIUS must make a determination to disapprove the transaction.

b. International Investment and Trade in Services Survey Act. Under the International Investment and Trade in Services Survey Act (the "IITSS Act") Non-US persons that own a voting interest of 10% or more in a US business enterprise must report such ownership to the Bureau of Economic Analysis ("BEA"). The report must be filed with the BEA within forty-five (45) days after the investment transaction. Although the report is an information filing and is confidential, it requires disclosure of detailed information (both financial and non-financial) regarding the transaction, the parties and the amount of the investment. The requirement for additional on-going reporting will vary based on the size of the entities involved. It is important to note that in addition to acquisitions of third parties, the IITSS Act also covers the formation of new entities. As a result non-US businesses that establish wholly-owned subsidiaries in the United States must comply with the reporting requirements under the IITSS Act.

c. Hart-Scott-Rodino Act. The Hart-Scott-Rodino Act (the "HSR") requires that the parties to certain significant transactions file a pre-merger notice with both the US Federal Trade Commission (the "FTC") and the US Department of Justice (the "DOJ") giving the FTC and DOJ an opportunity to assess, before the consummation of a transaction, the potential for the transaction to adversely affect competition in violation of federal antitrust laws. The HSR filing requirements apply to stock and asset purchases and sales, mergers, and the formation of joint ventures. A filing party generally is required to identify the parties involved, the structure of the transaction and other industry and ownership information and to provide copies of certain planning and evaluation documents that pertain to the proposed transaction. The HSR filing fee varies with the size of the transaction.

d. Foreign Investment in Real Property Tax Act. The Foreign Investment in Real Property Tax Act ("FIRPTA") provides that dispositions of real property held by a non-US person are subject to federal taxation as if the non-US person were engaged in a trade or business in the United States and as if the gains were effectively connected with such trade or business. Under FIRPTA, (i) purchasers of real property held by a non-US person are required to withhold 10% of the amount realized on the disposition of the real property; (ii) a non-US corporation that distributes a US real property interest must withhold a tax equal to 35% of the gain it recognizes on the distribution to its shareholders; and (iii) a domestic corporation must withhold a tax equal to 10% of the fair market value of the property distributed to a non-US shareholder if (1) the shareholder's interest in the corporation is a US real property interest, and (2) the property distributed is either in redemption of stock or in liquidation of the corporation.

e. Agricultural Foreign Investment Disclosure Act. The Agricultural Foreign Investment Disclosure Act ("AFID") establishes reporting requirements for certain acquisitions or transfers of agricultural land interests by non-US persons. With a few exceptions, AFID requires non-US persons to submit a report to the Department of Agriculture within ninety (90) days of any transfer or acquisition of interests in agricultural land or changes in the use of agricultural land.

7. Conclusion. Despite the myriad of laws and regulations within the three-tiered regulatory system within the United States, carefully planning and consultation with qualified and experienced legal, tax and financial advisors can ensure that a non-US business does not encounter any unexpected or avoidable issues or incur penalties or restrictions when launching business operations within the United States. With careful planning and qualified counsel, non-US businesses can achieve substantial success in the US marketplace.