Tannenbaum Helpern Syracuse & Hirschtritt LLP

Corporate Structuring of a U.S. Business

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Corporate Structuring

- The primary driver of structure in US-bound investments is often tax planning.
- The tax effects of investing in US businesses depend on numerous factors:
  - Tax laws in the originating jurisdiction.
  - Whether or not the originating jurisdiction and the US have a tax treaty.
  - The tax and corporate characteristics of the investor in its home jurisdiction (e.g., is the investor an individual, a corporation, an entity with pass-through tax attributes?).
  - The characteristics of the US target from a tax perspective; e.g., is it a pass-through entity or not?

Corporate Structuring (…cont'd)

- A foreign entity is subject to US income tax if it is engaged in (considerable, continuous and regular) business activity in the US.
- Since foreign investors must file a US tax return to report income from pass-through entities, they often use an intermediary entity between the investor and the target (a "blocker"). Depending on numerous factors the blocker may be a US entity or a foreign entity.
- A foreign investor should have US and home-jurisdiction counsel and accountants to determine the optimal structure.
- When establishing a US subsidiary for the purpose of conducting US activities, transfer pricing can be a relevant consideration.
- Sales Taxes: Since the US Supreme Court's 2018 decision in *Wayfair*, a business that has no physical presence in a state can nevertheless be required to collect and remit sales taxes there.

Corporate Governance

- Once the investor has chosen the structure for its business in the US, the investor needs to set up its US entity.
- Jurisdiction:
  - In the US (other than banks, which may be formed under federal charters), entities are formed in one of the fifty states or several territories of the US. Each has its own forms of entities and its own laws governing the formation and operation of the entities and the rights and duties of its equity-holders and third parties vis-à-vis the entity.
  - Delaware's corporate laws are seen as investor- and business-friendly, and its Court of Chancery is renowned, so it is a destination of choice. As of Delaware's 2017 annual Report:
    - 66.8% of fortune 500 Companies are Delaware companies
    - 80% of US based IPOs were Delaware entities
  - Other states, like New York, with favorable corporate statutes and well-respected commercial courts, are also seen as good destinations, especially if the business is planning on operating only there (especially to avoid paying annual filing fees in multiple jurisdictions). But beware of large owner liability to employees in NY.

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Corporate Governance (…cont'd)

- Form of Entity Selection
  - Foreign entities will most likely choose one of the following entities to use to carry on business in the US (in each case, with or without the use of blockers depending on tax structure decisions):
    - Corporation (a so-called "C-Corp") (*Note*: there are also S-corps that are tax pass-through entities, but non-US persons may not be owners)
    - Limited liability company (LLC)
    - Both corporations and LLCs benefit from limited liability, the equity-holders' liability is limited to the loss of any capital they contributed to the entity (absent extremely exceptional circumstances, such as fraud)

Corporate Governance (…cont'd)

- Ownership
  - Corporations are owned by one or more stockholders.
  - LLC's are owned by one or more members. A single-member LLC is disregarded for US federal tax purposes and considered the same taxpayer as its sole member; with two or more members, it is taxed as partnership, generally a pass-through entity. Tax elections to choose other treatment are often available.

Corporate Governance (…cont'd)

- Form of Ownership
  - Corporations' stockholders own capital stock of the Corporation.
    - There may be multiple classes of stock, each with its own rights, preferences and restrictions, including with respect to:
      - Voting
      - Dividends
      - Distribution of corporate assets
    - Stock may be voting or not-voting
    - Within a class, dividends and distributions are paid pro rata based on stock ownership

Corporate Governance (…cont'd)

- Limited liability company ownership is represented by membership interests.
  - Membership interests are often denominated in terms of percentage ownership or in Units (which essentially treats them like "shares".
  - Like corporations, there may be multiple classes of membership interest with varying rights, preferences and restrictions.
  - LLCs allow tremendous flexibility in structuring the entitlement to receive distributions, the proportions of distributions received, the order of priority in which they are received, etc.
  - Different classes of membership interests may entitle, prohibit, or limit, a member's right to vote, or participate in the management of the LLC.

Corporate Governance (…cont'd)

- Management.
  - In a corporation:
    - The stockholders (or the voting classes of stockholders) elect the board of directors.
    - The board of directors is responsible for the management and governance of the corporation's business.
    - The Board designates various officers (e.g., President, CEO, VPs, Secretary, Treasurer) to see to the day-to-day affairs of the corporation and exercise any other delegated powers the Board sees fit to turn over to them.
    - Stockholders' agreements can require the consent or approval of stockholders or any percentage of specified classes for the corporation taking any number of specified actions.

Corporate Governance (…cont'd)

- In an LLC:
  - There's a tremendous degree of flexibility in the organization of an LLC's management.
  - An LLC can be managed by its all of its members or any class or subset of its members.
  - Alternatively, it can be managed by one or more non-member managers.
  - The LLC's limited liability company operating agreement (similarly to a corporate shareholders' agreement) can require the consent or approval of members or any percentage of specified classes for the LLC taking any number of specified actions.

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Some Initial Considerations and Restrictions in Investing in the US (…cont'd).

- An investor will also need to assess a plethora of considerations in deciding to start or invest in a US business, including these (many of which we will examine more closely presently):
  - Compliance with the multitude of state and local laws in the states and localities in which the investor intends to carry on business.
  - Whether the investor's home jurisdiction has a bilateral investment treaty or trade agreement with the US, which may provide for favorable trade effects, and otherwise affect the consequences to the investor of doing business in the US.
  - Protecting the IP of the business in the US.
  - Employment laws and employment-related taxes if the business intends to employ anyone in the US.
  - Immigration laws, if any of its non-US personnel will work in the US.

Some Additional Considerations and Restrictions in Investing in the US

- Tariffs
  - The U.S. Harmonized Tariff Schedule (HTS) sets forth tariffs on a number of categories of goods imported into the US, including:
    - Animals and animal products
    - Minerals
    - Chemical products
    - Metals
    - Vehicles
    - Others
  - President Trump's administration has imposed a number of new tariffs on additional products, including steel and aluminum, and most significantly a tariff on over 800 categories of goods from China.

Some Additional Considerations and Restrictions in Investing in the US (…cont'd)

- Foreign Investment Restrictions
  - US federal law requires the review by the Committee on Foreign Investment in the United States (CFIUS) of mergers, acquisitions, or takeovers by or with a foreign person which could result in foreign control of a US business which may affect US national security.
  - CFIUS review can affect transactions in many industries (including energy, mining, technology and others) and is focused on the potential risks of the transaction to national security. CFIUS review can result in a transaction being prohibited (rarely) or subjected to conditions and agreements that will limit the potential security risks of the transaction.

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