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**Establishing a Business in the us: Do's and Don'ts of
structure, tax, ip, employment and immigration,
compliance and other legal matters**

Tax considerations for establishing a business in the us

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Introduction

Typical Fact Pattern

- Swedco has developed a B2B ap that allows business to assess, monitor, and address certain business risks
- Swedco has a small following of customers in the U.S. that purchase the product directly from the the Swedco's web site
- Swedco wants to expand presence in the U.S. in a phased-in plan and contemplates engaging two sales reps, one for the east coast and the other for the west coast
- The Sales reps will promote the B2B ap in general, will participate in trade shows, and will visit potential and actual customers to explain the product, discuss pricing, and answer technical questions
- Swedco wishes to avoid being engaged in a US trade or business so that it will have no obligation to file tax returns or pay U.S. taxes. To that end:
 - The sales reps will be “independent contractors”
 - All contracts negotiated by the sales reps will be subject to acceptance in Sweden
 - The sales reps will report to the Director of international sales
 - The sales reps will receive base compensation and a bonus based on sales from customers visited
 - The sales reps cannot represent competing products
- At some point, Swedco will form a U.S. subsidiary to promote the product in a big way
- Senior management of Swedco may be assigned to the U.S. to oversee a rollout in the U.S.

Typical Issues

- Is Swedco subject to U.S. income tax as a result of existing internet sales?
- Does Swedco have an obligation to collect sales tax in connection with the existing internet sales?
- Will Swedco's employment of "independent contractors" protect the company from having to pay tax?
- If not, how will tax be computed?
- Who should own the U.S. company, Swedco or its shareholders?
- Once a U.S. affiliate is formed will it act as an agent or as a distributor of Swedco?
- What rules apply to establishing a fee to the U.S. affiliate or the sales price for a digital product to the U.S. affiliate?
- How will management assigned to the U.S. be taxed in the U.S.?

Wayfair Case

State Sales Taxes Based On Economic/Digital Presence

- Prior law - U.S. Supreme Ct. cases - *National Bellas Hess, Inc.* (1967) and *Quill Corp.* (1992).
- Under the Commerce Clause of the U.S. Constitution an out of State seller without "physical presence" cannot be required to collect sales tax on sales to State residents.
- Market Change: Access to the Internet during the late 1990s and early 2000s enabled online retailers to conduct massive amounts of business in States without a physical presence.

State Sales Taxes Based On Economic/Digital Presence

- U.S. Supreme Ct. in *South Dakota v. Wayfair, Inc.* (2018) overruled those cases and held that
- The standard under other Commerce Clause precedent is "substantial nexus", which under current market conditions does not require "physical presence"
- The physical presence rule was unfair
 - Remote sellers have a competitive advantage over local and out of State competitors required to collect and remit the tax
 - States are deprived of sorely needed sales tax revenues

State Sales Taxes Based On Economic/Digital Presence

- South Dakota's statute requires substantial connection
 - Sufficient connection based on seller's economic and virtual contacts with the State
 - Statute's sales volume and number of transaction thresholds were sufficient to show connection
- Certain issues were to be decided in a subsequent proceeding before the case would become final

State Sales Taxes – Progeny of Wayfair

- 33 states currently have an economic nexus standard

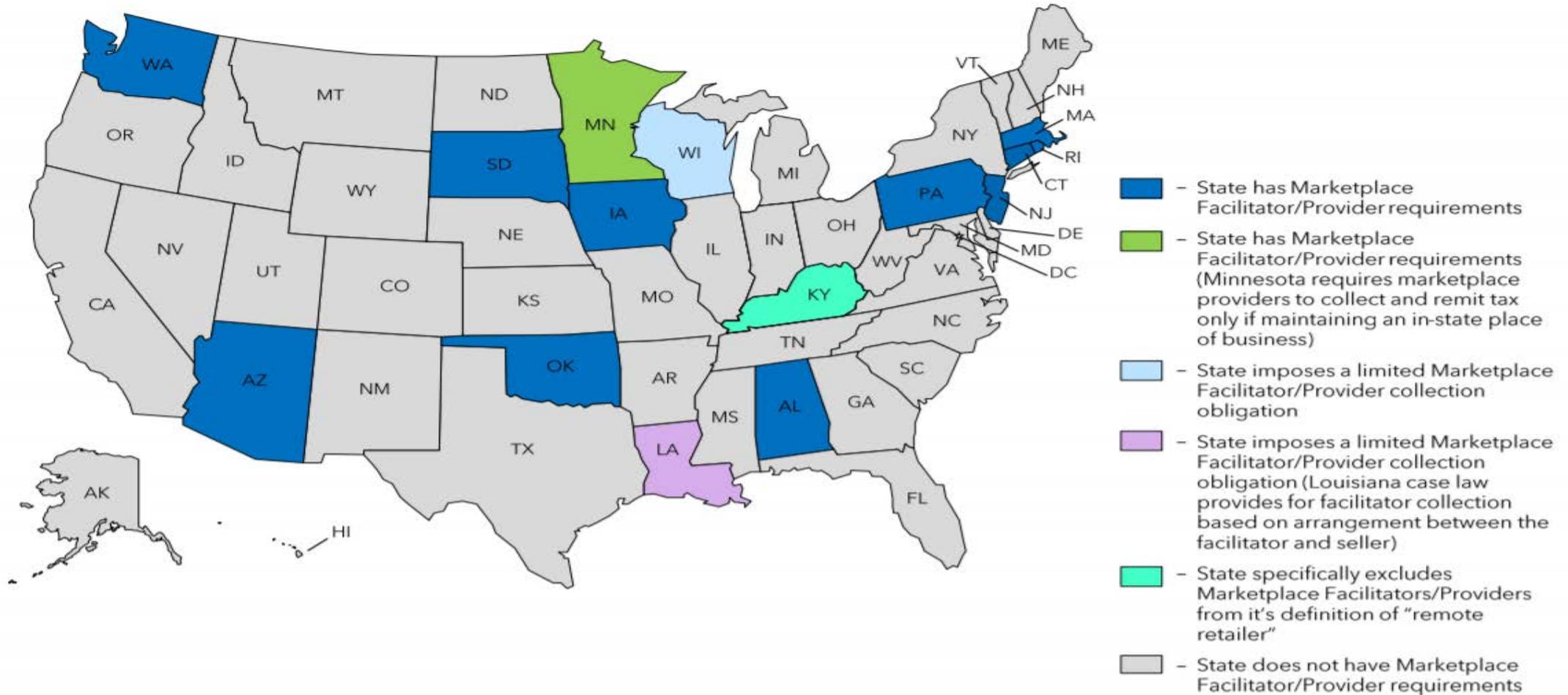
Snapshot of post-Wayfair Enforcement Dates	
2018	
June 21, 2018	New York
July 1, 2018	Hawaii
Oct. 1, 2018	Alabama, Illinois, Indiana, Kentucky, Maryland, Michigan, Minnesota, Nevada, North Dakota, Washington, Wisconsin
Nov. 1, 2018	New Jersey, North Carolina, South Carolina, South Dakota
Dec. 1, 2018	Colorado, Connecticut
2019	
Jan. 1, 2019	District of Columbia, Georgia, Iowa, Nebraska, Utah, West Virginia
Feb. 1, 2019	Wyoming
April 1, 2019	California
June 1, 2019	Idaho
July 1, 2019	Virginia, New Mexico, Arkansas
Oct. 1, 2019	Texas
Unspecified Date	
After Jan. 1, 2019	Louisiana

* Source: Bloomberg Tax, “Post-Wayfair Nexus Activity Roadmap”

State Sales Taxes – Progeny of Wayfair

- ▶ No uniformity in the standard for economic nexus
 - ▶ Wayfair standard – 200 separate transactions or \$100,000 in sales revenue to state residents
 - ▶ California – \$500,000 in sales revenue
 - ▶ Connecticut – \$ 250,000 and 200 transactions
 - ▶ Massachusetts – \$500,000 and 100 transactions
 - ▶ New York – \$300,000 and 100 transactions
 - ▶ Pennsylvania – \$100,000
- ▶ Some, but not all, states impose an obligation on a market place facilitator to collect and pay over sales tax to the state
 - ▶ Amazon.com Inc., eBay Inc., and Etsy Inc.

State Sales Taxes – Progeny of Wayfair



Source: Bloomberg Tax, "Jurisdictions with Marketplace Facilitator/Provider Requirements" (as of 16 October 2018)

State Sales Taxes – U.S. Federal Legislative Proposals

Federal (116th Congress)	N/A	<p>H.R. 379, the “Protecting Businesses from Burdensome Compliance Act of 2019” (Introduced Jan. 9, 2019).</p> <p>Press Release: Gibbs Introduces Online Sales Tax Bill, Protects Consumers and Small Businesses (Jan. 9, 2019).</p>	<p>U.S. Rep. Bob Gibbs (R-OH) re-introduced a bill that would require states to enact certain legislation as a condition to imposing any economic nexus provisions on remote sellers. The conditions include: (1) establishing a uniform tax rate; (2) centralizing remittance of sales tax to one location; and (3) provide a uniform statewide tax base.</p>
		<p>S. 128, the “Stop Taxing Our Potential Act of 2019” (Introduced Jan. 15, 2019).</p> <p>News Coverage: State of Wayfair: Tax-Free State Lawmakers Reintroduce STOP Act (Jan. 18, 2019).</p>	<p>Sens. Jon Tester (D-Mont.), Jeanne Shaheen (D-N.H.), Maggie Hassan (D-N.H.), Ron Wyden (D-Ore.), and Jeff Merkley (D-Ore.) re-introduced legislation to prevent tax collection obligations and information reporting requirements on sellers with no physical presence in the state. The five senators represent three of the five states that do not impose a general sales tax.</p>
		<p>S. 765/H.R. 1725, the “Digital Goods and Services Tax Fairness Act of 2019” (Introduced March 13, 2019).</p>	<p>Sen. John Thune (R-SD) reintroduced a bill to “prevent discriminatory and duplicative taxes on digital goods and services, including online downloads of music, literature, movies, mobile apps, and cloud computing services.” The bill was also introduced in the House, by U.S. Rep. Steve Cohen (D-TN).</p>
		<p>H.R. 1933, the “Online Sales Simplicity and Small Business Relief Act of 2019” (Introduced March 27, 2019).</p>	<p>U.S. Rep. Jim Sensenbrenner (R-Wis.) reintroduced legislation that would, among other things, prohibit states from imposing retroactive sales tax collection requirements on remote sellers.</p>

Source: Bloomberg Tax, “Post-Wayfair Nexus Activity Roadmap

Permanent Establishment

Permanent Establishment – A threshold to tax Business Profits

- Sweden - U.S. Income Tax Treaty
 - Article 7 (Business Profits) - A Swedish enterprise is taxed by the U.S.
 - If it carries on business through a U.S. Permanent Establishment ("PE"),
 - But only to the extent of the profits attributable to that PE
 - Article 5 (Permanent Establishment)
 - A PE is a fixed place of business ("FPB") through which the business of an enterprise is wholly or partly carried on

Permanent Establishment – A threshold to tax Business Profits

- The Treaty lists examples of a FPB that is a PE, including:
 - A place of management
 - A branch
 - An office
 - A factory
 - A workshop.
- The list is illustrative and non-exhaustive

Permanent Establishment – A threshold to tax Business Profits

- Use of a FPB for preparatory or auxiliary activities generally does not create a PE.
 - Such activities are not by themselves income producing, even though they may assist the enterprise in its business activities
- Examples:
 - Use of a facility solely to store, display or deliver merchandise, or maintaining a stock of goods solely for such purposes or for processing by a third party
 - Use of a FPB solely for purchasing goods or merchandise, or advertising or collecting information
 - A combination of these activities will not give rise to a PE.

Permanent Establishment – A threshold to tax Business Profits

- When will an agent constitute a PE of the Swedish enterprise?
 - A Dependent Agent is treated as a PE
 - This is an agent that is neither legally nor economically independent of its principal
 - Example
 - An employee
 - A “contractor” over whom the principal can direct not only what must be done, but how it will be done
 - A “contractor” that reports to the principal as would an employee of the principal
 - A “contractor” that is financed by principal
 - To be a PE, the Dependent Agent must have and habitually exercise an authority to conclude contracts in the name of the enterprise
 - If the agent’s activities are limited to preparatory or auxiliary actions, it is not a PE

Permanent Establishment – A threshold to tax Business Profits

- When will an agent constitute a PE of the Swedish enterprise?
 - An Independent Agent is not a PE
 - This is an agent that is legally and economically independent of the principal
 - Examples
 - A broker or general commission agent where the agent is acting in the ordinary course of its own business
 - In general, status as an Independent Agent requires:
 - Legal independence
 - Lack of control over the agent's activities on behalf of the enterprise
 - Limiting agent's discretion, such as by detailed instructions (as distinguished from mere ownership)
 - Economic independence
 - The agent bears entrepreneurial or business risk of loss from its own activities

Permanent Establishment – A threshold to tax Business Profits

- Related Company – A Swedish company does not have a PE in the U.S. *merely because* it controls, or is controlled by, a company that is a resident of the U.S. or which carries on business in the U.S.
 - Whether or not a related company is a PE is determined by applying the factors noted above and not on the ownership or control relationship between the companies
 - However, a subsidiary which acts as a Dependent Agent would still be treated as a PE, despite the above parent-subsidiary rule
- Distributor – A U.S. subsidiary, acting as the Swedish company's U.S. distributor, is not a PE where:
 - It purchases products from the parent at arm's-length prices
 - It sells products, in its own name to independent retailers and wholesalers in the U.S. at prices and under terms it determines

Transfer Pricing

Transfer Pricing

- Basic premise of U.S. tax law regarding intercompany transactions between a U.S. business and its parent or affiliates outside the U.S.
 - All transactions between the parent and its European affiliates and the U.S. subsidiary must be carried on under arm's length terms and conditions so that it allows each party's results to clearly reflect income
 - Where prices differ from an arm's length amount, the I.R.S. is authorized to adjust the transaction value to ensure arm's length results are achieved
- Intercompany transactions subject to the rule
 - Inventory purchases
 - Interest expense on loans
 - Royalty expenses on use of IP
 - Lease payments on lease of goods
 - Management and other fees to parent

Transfer Pricing

- The U.S. does not follow the transfer pricing guidelines of the O.E.C.D. Rather, regulations issued by the I.R.S. control
- All related party transactions must be reported to the I.R.S. on Form 5472, which is part of the annual tax return
 - It provides a road map for the I.R.S. examination team
 - \$25,000 penalty is imposed for failing to submit form fully completed

Transfer Pricing

- The failure to charge an arm's length price which artificially reduces the income of the U.S. affiliate will result in a penalty of either 10% or 20% of the increase in tax resulting from a transfer pricing adjustment
- The penalty can be reduced or eliminated if a transfer pricing report is prepared that meets the following conditions:
 - It is prepared not later than the filing date of the return
 - It justifies the prices charged in light of the transfer pricing regulations
 - It is reasonable to rely on the report

Transfer Pricing

- **Basic premises of regulations:**
 - There is no single appropriate transfer price
 - A transfer price clearly reflects income so long as it falls within a range of arm's-length results
 - The justification of a transfer price is established by reference to comparable transactions
 - Third-party comparable transactions of the taxpayer in comparable circumstances
 - Third party comparable entities – this measures various financial ratios
- **Several acceptable transfer pricing methods:**
 - The comparable uncontrolled price method for sale of inventory/comparable uncontrolled transaction method for use of IP
 - The resale price method also for the sale of inventory to a distributor
 - The cost plus method for a manufacturer selling to a distributor
 - The comparable profits method based on financial ratios
 - A profit split method
 - Synthetic credit rating or Adjusted Federal Rate for interest charged on intercompany loans

Individual Income Tax Concerns

Becoming a U.S. Tax Resident

- Formally move to the U.S.
 - Green Card? Other visas?
- Travel frequently to the U.S.
- There could be a difference
 - Location of family
 - Availability of closer connection exemption
 - Availability of treaty tie breaker

Counting the Days

- A U.S. resident if:
 - 31 days during the current year, and
 - 183 days or more during the last three years, counting:
 - All the days present during the current year
 - $\frac{1}{3}$ of the days present the previous year, and
 - $\frac{1}{6}$ the days present the year before that

Avoiding U.S. Tax Residence Status

- Closer connection exception available only to those who spent less than 183 days in current year
- Treaty “tie-breaker” available to those eligible for treaty benefits and can demonstrate center of life in Sweden
- Rule of thumb for those frequently visiting – count the days and keep it to below 121 days a year
 - Day of arrival and day of leaving are counted as full days in the U.S.
 - Examples:
 - Mr. A is scheduled to depart the U.S. on a 10:00 p.m. flight to Europe. His flight is delayed because of later arrival of aircraft and departs at 12:01 A.M. of the next day. That 1 minute counts as a full day in the U.S.

Green Card

- Don't rush to get it
- Once obtained, becomes a U.S. tax resident regardless of the day count
- U.S. tax residency remains until Green Card is formally revoked or relinquished
 - Immigration rules different than tax
- After 8 tax years – could be expensive to give up
 - Even 1 day in a tax year counts
 - Years in which a treaty “tie-breaker” position taken do not count
 - Risk of immigration effects

Effects of Becoming a U.S. Tax Resident

- U.S. tax on worldwide income and gains
- Possible U.S. tax on income earned by non-U.S. corporations prior to distribution
 - Possible double taxation
- Ownership of less than 10% in a non-U.S. corporation otherwise owned by non-U.S. persons could attract additional adverse tax consequences
- If also Swedish resident - tax rate on global income @ the higher of the two countries

Effects of Becoming a U.S. Tax Resident

- U.S. reporting of foreign financial accounts if:
 - Financial interest in account, or
 - Signatory authority over account
- U.S. reporting on $\geq 10\%$ -owned non-U.S. corporations and partnerships
- U.S. reporting of lower ownership if certain facts exist
- U.S. reporting of receipt of foreign gifts and distributions from foreign trusts
- Becoming a U.S. domicile?
 - Estate tax
 - Gift tax
- Exposure to “exit tax” if/when moving back?

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