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**Establishing a Subsidiary in the United States:
Legal, Accounting, Tax and Commercial Considerations**

Owners of foreign businesses, and their advisors, inevitably consider establishing a U.S. office for marketing, sales, maintaining existing customer and supplier relationships. Operating a U.S. business fills out the global footprint necessary to compete in today's global economy.

This memorandum provides an introduction to basic concepts and procedures for establishing and initiating operations of a subsidiary in the United States. We do not discuss why or how to establish a U.S. branch (unincorporated office of the foreign company), since our foreign clients normally establish separate entities in the United States to limit liability and avoid operational confusion. Nor do we consider here how to acquire an existing U.S. business. Accordingly this discussion is general in nature and might not apply to your particular circumstances.

I. Applicable Law Governing Internal Relations of Shareholders and Juridical Entities.

Under the United States federal system, the legislation of the local state (and not federal law) where a legal entity is established will normally govern exclusively the internal relationship among shareholders, the board of directors, the officers in a corporation (or other juridical entity) and, sometimes the employees and certain third parties. Exceptionally, California applies its internal corporate law to non-California corporations a majority of whose shares is owned by residents of California. Federal law also governs certain shareholder rights to fair disclosure in public offerings of securities for sale to the public, unless the securities are exempt from securities registration requirements.

The widespread use of Delaware corporations is permitted by rules on the Constitutional freedom of a juridical entity established in one American state to register to do business and conduct its affairs in other states and even outside the United States. As a result, the choice of the state of incorporation may be important and can result in significant advantages or disadvantages, according to the various investor needs.

A. U.S. Domestic Laws.

Certain state corporation laws govern the relationship between shareholders and employees.

This exposure in a manner that exposes the shareholders to civil liability in certain defined circumstances may be unforeseen unless the shareholders anticipate that there will be no employees, or that they will be the sole employees. In the case of incorporation law of New York, the ten largest shareholders of a New York corporation are personally responsible for the payment for certain unpaid salaries under certain conditions. As a result, we advise the use of a corporation established in Delaware, qualified to transact business in New York, for this and other significant reasons.

B. Foreign Domestic Laws.

Under local state laws, juridical entities organized outside the United States may directly conduct business and directly own investments in the United States. (Local and federal law may govern their ability to conduct certain types of regulated businesses, and reporting and compliance requirements may apply also.) Special purpose offshore entities should be considered in unique situations, such as for mixed U.S. and foreign ownership or limited foreign regulation of related offshore business. The choice of the law for establishing a legal entity is affected by tax, regulatory, treaty, legal and personal factors.

II. Overview of Choice of Form of Legal Entity.

The laws of different states offer a wide variety of forms for legal entities. In addition to the stock corporation law, there are “limited liability companies” (“LLC”) (which resemble the S.A.R.L. or GmbH in French and German law. LLC’s are more difficult and complicated to establish than the ordinary general stock corporation. Other legal entity forms include general partnerships, limited partnerships, limited liability partnerships and trusts for business or personal operations.

Some states picture themselves as havens from creditors, wars, revolutions and nationalization elsewhere. Alaska has adopted a form of “asset protection trust.” Delaware allows foreign corporations to change their domiciles to Delaware upon the occurrence of specified events such as resolutions, change of constitutional form or other events in the foreign country. Asset protection strategies and tools – such as holding companies and offshore trusts -- remain an important strategy for foreign investors.

The “yes” and “no” answers below all require some degree of explanation. Special conditions apply in certain cases. Exceptions apply under principles adopted under judicial decisions that, as “common law,” ignore statutory law depending on exceptional facts and circumstances.

Characteristics	Corporation	Limited Liability Company	Partnership			Not-for-Profit Corporation	Trust
			General	Limited	Limited Liability Partnership		
Limited liability for owners	Yes	Yes, unless Operating Agreement specifies otherwise	No. But yes if interpose a holding company	Yes for limited partners, no for general partner	Yes for all partners	No owners. Public trust	Yes
Who may be an owner (assuming the entity and owners comply with normal registration and compliance rules)	“C” corporations: Any person or legal entity “S” corporations: only U.S. citizens, resident aliens and certain estates and trusts	Any person or legal entity	Any person or legal entity	Any person or legal entity	Any person or legal entity that is licensed as a professional to render services (e.g., accountants, attorneys, doctors, dentists, engineers, etc.)	Not applicable. Members have voting rights but no ownership rights (except for subvention certificates that evidence capital contributions). Not-for-profit corporation may have no members.	Any person may be grantor. Any person may be a trustee, but trustee’s residence is a basis for applying local U.S. law.
Minimum number of owners	One shareholder	One member	Two general partners	Two, including one general partner and one limited partner.	Two partners with limited liability	None.	One grantor, one trustee and one beneficiary
Maximum number of owners	“C” – unlimited. “S” – 100 shareholders.	None	Two partners	Two	Two	Not applicable	One grantor, one trustee, one beneficiary or class of beneficiaries
Unlimited duration of entity	Yes	Yes, unless otherwise agreed	Yes, unless otherwise agreed			Yes	No, unless law permits
Managers may be non-owners	Yes	Yes	No	Yes (General Partner)	No	Yes	Yes. Trustee

Characteristics	Corporation	Limited Liability Company	Partnership			Not-for-Profit Corporation	Trust
			General	Limited	Limited Liability Partnership		
Who is taxable on entity's income (general principle, subject to exceptions and conditions)	"C" – corporation. Also, shareholders are taxed on dividend distributions. "S"- the shareholders	The shareholders (assuming they elect to be taxable as partnership)	Partners	Partners	Partners	No tax, except for "unincorporated business taxable income" from non-exempt activities	The trust or beneficiaries as distributes (if irrevocable trust); the grantor (if revocable trust)
Owner has right to know about company's business	Yes, subject to valid corporate purpose for knowing.	Yes, except as provided in Operating Agreement and except (in Delaware) for confidential business information	Yes. Fiduciary duty	Yes, but limited partner may not manage the business.	Yes, and ethical duties apply under relevant code of ethics of the regulated profession.	Yes, and subject to audit by judges and attorneys general or other regulatory enforcement in the public interest.	Yes, but depends on the trust instrument.

The choice of the form of legal entity is determined by principally by tax, legal and management factors. Where there is an international income tax convention between the United States and the foreign owners' domicile, a stock corporation can achieve tax results similar to that LLC.

III. The Delaware Corporation.

Delaware is frequently chosen as a site for incorporating companies because of its reputation for flexibility, giving control to majority owners, protection of directors and officers under certain conditions, and the avoidance of several legislative features that might, for example, impose liability on shareholders for employee wages under certain circumstances. The following discussion will focus on the General Corporation Law of Delaware. The legislation of other states may contain different provisions.

1. Procedure and Calendar for Establishing a Stock Corporation.

a. Procedure. The establishment of a stock corporation includes several stages.

i. Name Availability. Before filing a certificate of incorporation to establish the corporate existence, it is necessary for the company to select an appropriate name where the name is available in all the locations where the corporation contemplates conducting its business.

- (A) Reservation of Name. The name must not be confusing with any name already registered in the state of incorporation or in the state where the operations of the company are intended. In order to eliminate any risk of the unavailability of the name, it is advised to reserve the name, which normally can be done for 90 days (in Delaware) or in 30 or 60 days elsewhere (according to the state in question). The cost of such name reservation is fairly modest (for example, \$75 in Delaware).
 - (B) Mandatory Parts of a Name. As a general rule, the name of a corporation requires use of one of the following words in the corporate name: "Corporation", "Corp.", "Limited", "Ltd.", "Incorporated", "Inc." Commercial corporations may not have the following words in their corporate name: "Trust", "Bank", "Police", "Benevolent" or similar words. In each case, statutory requirements must be consulted.
 - (C) Fictitious Names. In many states, the officially permitted corporate name may be different from the name that might be required in another state. Delaware corporations may thus have names that, if used in another state, would denote a partnership, for example. Thus, the stock corporation in Delaware qualifies as such if it includes one of the words "Association," "Club," "Fund," "Institute," "Society," "Syndicate" or "Union." When such corporations elect to conduct business in another state, the corporation must adopt a "fictitious name" in the other state.
 - (D) Foreign Names. Delaware also permits the use of abbreviations denoting limited liability of shareholders, such as "Corp." or "Inc." To promote international usage, such Delaware corporations may use such abbreviations or denominations from other languages, such as "Limitada" ("Ltda.") in Spanish, "Société Anonyme" ("S.A.") in French or "Kabushiki Kaisha" ("K.K.") in Japanese. Such flexibility is not respected in the other states, so such Delaware corporations must adopt fictitious names when conducting business through offices in the other states.
- ii. Filing of Certificate of Incorporation. A corporation is organized and established the moment of the filing of its charter with the Secretary of State in question, who receives and files in a public record the original of the Certificate of Incorporation. An incorporator, or multiple incorporators who need not be U.S. citizens must sign such certificate.
- (A) Legal Liability of the Incorporator(s). The incorporator has certain legal obligations. The incorporator certifies the facts in the certificate

of incorporation and is personally responsible for any commercial activity of the corporation before the issuance of shares and the resulting capitalization for commercial operation.

- (B) Activation of the Corporation. Typically, the incorporator appoints the initial board of directors immediately upon incorporation, and the board of directors issues the shares through acceptance of a subscription by a subscriber, who then deposits money or monies worth into the corporation's bank account or its balance sheet. However, such "activation" of the corporate governance structures (such as the adoption of by-laws or a shareholders' agreement to buy and sell shares on death or termination of employment, for example) is not legally required.

- iii. Qualification to Conduct Business in a state other than Delaware. Foreign corporations (that is, those not incorporated in a state) are authorized to pursue commercial activity in other states, as of the date when the request for a certificate of authority to conduct business is filed in the Secretary of State with that other state. In order to file such a request, normally the state of incorporation issues a "certificate of good standing," which certifies the corporate existence of the corporation.

- iv. Issuance of Share Capital. The issuance of share capital requires
 - (A) subscription (or frequently without subscription, but with an acceptance of a verbal subscription) and
 - (B) the payment of a capital contribution. Typically, this is done by transfer to a bank account with the name of the corporation or in an independent account (also for the benefit of the corporation) pursuant to which funds are reserved for the exclusive use of the corporation, such as in a fiduciary account. This can be in a lawyer's escrow account. It is necessary for such payment in money (or money's worth, which may include services actually rendered) in order for the shares to have been issued.

Evidence that shares have been issued may take two forms: either by stock certificate, or, according to the applicable corporate law, without the issuance of a stock certificate but by the use of a share register. Such a share register is an internal corporate document and the ownership of corporate shares is not a public record unless the corporation must file public records pursuant to Securities and Exchange Law or is otherwise a regulated entity.

The formalities for opening a bank account take a week or two on average. American banks demand letters of reference from foreign banks under the

“know your customer” rules.

- iv. Accounting Records. We order the minute book of official acts of the corporation (as namely, signed copies of the shareholder actions and those of the board of directors with certified conformed copies of the documents filed with the Secretaries of State), the corporate seal, the share register, the stock certificate book in similar and similar documents which are required to be filed with the records of the corporation. Such minute books are submitted to us normally within a week after our purchase order. We prepare the necessary records in the minute book for the issuance of capital, once the necessary pre-conditions show up and satisfy.

b. Calendar.

- i. Formation of the Corporation. Once we have been advised of the necessary information, we can establish the corporation almost on the same day when the client gives the green light. In Delaware and other states, the Secretary of State accepts registration of certificates of incorporation by fax, however, we will not do so unless our fees have paid been in advance.
- ii. Registration in One State Other Than the State of Incorporation. Once the corporation has been established in Delaware, it is necessary to register in other states where it intends to conduct its business and to have offices. In such other states, the corporation will be considered to be a “foreign corporation,” even though it is still a corporation established under the laws of one of the states in the United States.

Failure to apply for a certificate of authorization to transact business in a state other than the state of incorporation can result in several adverse consequences. Such consequences vary according to the state where the business is actually being conducted outside the state of incorporation:

- In New York, the non-complying corporation must pay amounts in excess of the registration amounts, and the corporation which has not yet obtained the filing of its application for authority to do business in New York has no standing to file law suits in the courts of New York.
- In Colorado (Colo. Rev. Stat. §7-9-103 et seq.) the corporation may be subject to penalties in addition to the normal costs of initiating the establishment of its operation. The corporate offices may be put in prison and may face criminal penalties in certain cases. [Id., §7-9-1003 (4) (1973).]

Accordingly, it is desirable to immediately register the corporation to transact

business in such other states when that is contemplated. This process takes several days (if urgency is required) or a week or day by ordinary mail. To a certain extent, the timing depends upon the issuance of the certificate of incorporation and the good standing certificate in the state of incorporation, since the latter is required for qualification in the other states.

- iii. Taxation. The president or other officer must sign an application for an employer identification number with the Internal Revenue Service (IRS). This registration application (similar to such tax registrations in other countries, may be done by telephone, provided that the corporate officer is on the telephone, even if he does not speak a word of English)! Otherwise, the application for an employer identification number takes approximately three weeks to obtain. During this period banks will not agree to open the account without such corporate tax number.
- iv. Activation; Contracts; Employment. The Board of Directors authorizes important, such as the rental of premises or the hiring of key employees.
- v. Labor Department. For any employees, the new corporation must file an application with the labor department with the state where it will establish its business and have employees performing work. This needs to be coordinated with the company's accountants and a payroll service.
- vi. The Incorporation Process. In short, the incorporation of a stock corporation may be done by one person acting as sole incorporator on the day when he makes his final decisions about the terms of the certificate of incorporation. However, the necessary preparation and staging of tasks implies a calendar of approximately two or three weeks for ordinary completion of these formalities.

2. Corporate Name.

- a. Corporate Name - Several States. The name of a corporation may be used as such in the state of its incorporation (here, Delaware) as well as in any other state in which the corporate has filed a registration to transact business as a foreign corporation. This requires the acceptability of the name in the other state. A corporation from another country has the same legal value as a corporation from another state in the United States, each being considered a "foreign" corporation.

In order to preserve the corporate name, it is therefore necessary to register in each state in question as a reservation name. This procedure involves minimum corporate taxes, a fiscal audit and submission to the jurisdiction of the courts in that state. Such registration implies likewise the payment of annual costs and administration charges. In each case, it is necessary to have a "statutory agent" authorized to receive official correspondence and service of legal process initiated and related to

court litigation. The fees of statutory agents run from \$100 - \$200 per year.

- b. Fictitious Names. In some cases, it is necessary to adopt a fictitious name, trade name or doing business as name. Such cases include:
 - i. if the name of a corporation has already been used in a state, or
 - ii. if the name so resembles another corporate name in the other state as to create confusion and therefore to be denied registration in that state, or
 - iii. through the line if the name fails to include the obligatory statutory mention of the words denominating a stock corporation (such as “corporation”) or “incorporated”).

A fictitious name must be registered in the same way in which the company files for a qualification to transact business. Fictitious names are never used in the state of incorporation, which therefore requires the initial name search or a selection of a name that does not infringe on the name of an existing corporation.

- c. Trademarks and Web Domain Names. We call your attention to the utility of trademarks in order to obtain the commercial authority to exploit the corporate name throughout the United States. This situation arises from the fact that, regarding the names of corporations, the state laws of the states in question apply. Therefore, unless a right is granted by federal law, the name is reserved only in those states where the corporation has filed for its certificate of authority as a foreign corporation (aside from the state of incorporation). In contrast, the rights granted by trademarks are pursuant to federal law, and therefore are applicable throughout the entire United States.

Trademark registration protects not only commercial name. It also serves as the determining factor in protection of a company’s Internet Domain Name, which must be separately registered.

3. Corporate Headquarters.

The nominal corporate headquarters is located normally at the office of a service company, which occupies the function of statutory representative in the state of incorporation. For Delaware, domiciliation is therefore located at this agent. The place of operations, where employees actually perform productive work for the corporation, need not be indicated to the government in Delaware as in the first instance. One may establish the place of operations any place throughout the world, and meetings of the board of directors may likewise be held anywhere in the world.

4. Management.

- a. Board of Directors.
 - i. Powers and Obligations. In Delaware for example, “the business of each corporation established under this chapter are managed by and under the direction of the board of directors” [Delaware Gen. Bus. Corp. L., §141(a)]. Under an optional procedure, powers and obligations of the board of directors may be exercised by other persons if the certificate of incorporation so permits, as in the case of a “closed corporation” administered by the shareholders.
 - ii. Number of Members of the Board of Directors. The board of directors may be one or several people. The number is established according to the by-laws, which acts as the internal regulations. No member of the board of directors must be a shareholder. However, the by-laws may require additional conditions in order to determine the qualifications required in order to become or remain a director.
 - iii. Election, Succession. The members of the board of directors are normally elected until the election and installation of their successors in the absence of their resignation or involuntary termination otherwise. When each member has a term which expires at the same time one member may be eliminated by those holding a majority of the voting shares and this may be done either for cause or without cause [Id., § 141(k)]. In certain cases, it is possible to preserve the right to remain a member of the board if the member was elected by a certain class or series of shareholders, for so long as this class or series does not vote to fire the member. Like the “manager” of a GmbH, S.a.R.L., or Limitada, board members do not become employees of the company solely because they are board members.
 - iv. Voting. Normally a majority of the board of directors constitutes a quorum. Decisions are taken by a majority of the member present except if the certificate of incorporation requires a higher number.
 - v. Reliance Upon Others. A member of the board of directors of a corporation in the State of Delaware (as well in certain other states) has certain obligations to the shareholders. In the performance of such obligations, he has the right to rely upon the advice, information reports and counsel presented to the corporation by any “officer” or employee of the company, or by any other person that the member believes, reasonably, is included in the professional confidence or expertise and that he has been chosen in a reasonably prudent manner by, or on behalf of the corporation [Id., Sec. 141(e)]. This provisions protects the board of directors against shareholders.
 - vi. Meetings. In the absence of a contrary provision of the certificate of incorporation or the by-laws, the board of directors may hold its meetings at

any place in the world. Meetings may be held likewise by telephone, provided that each member “present” may hear and speak to each other member “present.” They may likewise may hold a meeting when all members of the board of directors simply adopt the resolutions or other corporate act unanimously by signing a document containing such resolutions or acts. Notice of Board meetings must be given at least 10 days, and not more than 50 days prior to the date of the meeting.

b. Officers.

- i. Powers and Obligations. In general, the officers exercise executive functions, in order to give effect to the policies, decisions and instructions of the board of directors. The by-laws (or a resolution of the board of directors pursuant to the by-laws) established the functions and responsibilities of the officers [Id., § 142 (a).] At a minimum, one must have a President and a Secretary.
 - (A) The President focuses on the execution of the policies of the board of directors. He is not necessarily a member of the board of directors.
 - (B) The Secretary (or other person appointed for such purposes) must preserve the corporate of the corporation, including those of the shareholders and the board of directors. The Secretary may therefor be a non-employee, such as an attorney, accountant or independent advisor. The same person may be the President and Secretary at the same time. Such person may likewise be the sole shareholder.
 - (C) There is no internal accounting officer required by law to audit the accounts of the corporation. Auditing is not required in order to maintain the corporation’s business existence.
- ii. Election; Succession. The officers are elected until the election of their successors, except in the absence of their resignation or involuntary termination otherwise. An officer may be fired by the decision of the board of directors, for cause or without cause. The by-laws govern the condition of officers. In general, the firing of an officer (or a member of the board of directors) does not normally involve any obligation to pay a severance or other indemnity, except where there was a contract of employment or other special conditions existed. Any discharge of a director or officer should normally therefore include a prior consultation with an attorney.
- iii. Prior Conditions. There is no prior condition requisite for being an officer. Therefore, a non-resident alien, being paid abroad and traveling to the United States on a B-1 (business visitor) or B-2 (visitor for pleasure) visa, has the right to act as an officer. However, care must be taken in such cases so as to

avoid conducting of business on behalf of the U.S. corporation while the non-resident alien is present in the United States. We suggest you discuss with us the scope of your anticipated activities and whether such visas would apply to you in your case (see below regarding taxation).

IV. The Delaware Limited Liability Company.

The concept of a “limited liability company” was adopted only in the late 1980’s. It follows the civil-law concept of a limited liability company managed either by the “members” (shareholders) or by non-member managers. But the internal structure is based on the concept of a business partnership, so many decisions must be made and documented.

a. Formation. A “LLC” is established by filing a certificate of formation with the Secretary of State, but this should only be done after the founders have adopted an operating agreement. The operating agreement governs the internal relationships and may specify what liability, if any, members shall have for debts of the LLC.

b. Complexity. LLC’s are complex to form since the operating agreement, like a partnership agreement, is totally negotiable. In a 100%-owned “subsidiary,” the operating agreement is not complicated. But if there is more than one member, the typical operating agreement will require negotiations among the founders concerning events relating to the voting and governance structure, contingencies such as the death, disability, incompetency or resignation of a member from management, the capital structure such as the rights of different classes of shares, and operating issues such as compensation of members.

c. Taxation. As suggested in the chart above, the LLC has the benefit of being eligible for “tax transparency,” or a single level of taxation. If the LLC fails to distribute profits to the members, however, the members will have to pay taxes on their allocable share of profits *even though there is no distribution of profits*. For this reason, most multi-owner LLC’s require some distribution of a minimum amount to cover at least this tax liability.

V. Lawful Right to Work in the United States.

Federal immigration laws govern the right of a foreigner to work in the United States. Once such right is established, the employment must still comply with other, generally applicable laws and regulations governing employment. For purposes of discussion, we will assume the foreigner will be employed by a juridical entity that is a corporation.

There are several choices for visas. We may cite the following cases:

- L-1 intracompany transferee
- H-1 alien with special experience
- E-1/E-2 treaty trader/ treaty investor
- J-1 trainee for 18 months

Our firm can assist in the processing of visa applications. We suggest that you consider the visa process as part of your normal checklist. Applications for visas require special attention. Visas and is not automatically granted. The process involves some degree of risk and some judgement, particularly in cases where the educational requirements or other conditions may justify some scrutiny by the Immigration and Naturalization Service (INS).

Under a B-1 or B-2 visa, a member of the board of directors or an officer may not receive a salary or other compensation from the U.S. for his services for the benefit of such corporation during his stay in the United States. This rule does not prevent payments to such person for the performance for services on behalf of the U.S. corporation done outside the United States (such as an international space) or a payment by a foreign affiliated company for conducting the sales and promotional function on behalf of the foreign affiliate during the stay of such person within the United States pursuant to the conditions of the B-1 or B-2 visa.

Accordingly, we recommend careful and thoughtful discussions concerning visa necessary before the establishment of subsidiaries in the United States.

VII. Accounting – “Fiscal Year.”

- a. Calendar Year vs. Fiscal Year. The board of directors normally adopts the corporate tax/fiscal year. There are different ways to adopt such fiscal year. Most frequently, this is done by decision of the board of directors at its initial meeting which adopts the fiscal year ending December 31. However, one may adopt a fiscal year other than December 31, and an international tax planning discussion should be had relating to manner in which the payment of dividends from one company to a foreign company may delay the payment of taxes from year to year.
- b. Maximum Duration. The corporate fiscal year may not exceed 12 months.

VII. Taxes on Taxable Revenue.

- a. Federal and International Taxes. The international tax regime of an American subsidiary involves several different complex points.
 - Classification as a corporation taxable as such or a partnership (not taxable and tax transparent). The tax classification of an entity will affect its tax regime. Stock corporations are which automatically classified as corporations and taxable as separate entities (unless an “S Corporation” election is adopted and there are no non-resident alien shareholders.) In the case of partnerships and other non-corporate entities voluntarily electing partnership tax treatment, such entities are not taxable, they are therefore transparent, but their partners are taxable on their social and pro-rata share of the corporate taxable income, which is characterized at the corporation level and distributed pro-rata for purposes of taxation.

- Income Tax Credit. Under the foreign tax regime, a tax credit for U.S. corporate income tax may be available. This is the case pursuant to income tax treaties in various countries as well as under foreign tax legislation where there is no such treaty.
- Deductibility of Expenses. Certain expenses are deductible in the calculation of taxable revenue under American law. Such expenses include:
 - start-up costs (see the Internal Revenue Code of 1986, as amended, § 195) notably the costs of an investigation and the establishment of a commercial activity, paid during the period before the creation or acquisition of a company.
 - organization costs (see the Internal Revenue Code of 1986, as amended, § 248) notably those associated with the creation of the corporation under certain conditions. In each case, the corporation may amortize such expenses over a 60-month period and deduct them pro-rata, per month.
 - trademark filing expenses, if elected to be amortized over 60 months.
 - interest between foreign parent corporation and subsidiary, provided that such amounts represent interest and are not disguised dividends or royalties or any other form of transaction justifying re-characterization and tax allocation otherwise.
 - transactions involving licenses, loans, sales research and development and other services, between the American company and its shareholders, managers and foreign affiliates. However, these economic relations must be disclosed on the U.S. corporate income tax return on a special form that discloses extensive information relating to each transaction between the affiliated companies or entities. According to international tax convention, the American law and foreign law all such transactions must be conducted on a commercial arms length basis, where they will be restructured by imputation and taxable in such a manner to give effects to “economic reality.”
- Loss “Carry Forward” in Subsequent Fiscal Years. Loses incurred in one taxable year may be used to reduce the corporate taxable income for tax years subsequent to the tax year (during 15 years) or prior to the taxable year (for a period of three years). Accordingly, the loses may be used to cover and reduce taxable gain in other taxable periods.

On the other hand, when all the shareholders are not residents of the United States and do not have any other revenue from U.S. sources, the loss carry

forward or carry back may not be advantageously used if the company is a “limited liability company (LLC)” as to which the tax regime for transparent “partnership taxation” has been adopted. Therefore, the selection of the form of LLC or stock corporation depends in part upon the anticipated tax losses during the start up phase.

- Tax Relationship with the Parent Company. U.S. business entities must keep a very close record of all transactions and contracts between the parent company and its subsidiary, as if the two had not been affiliated. To properly record the nature of such transactions, that all such relationships as loans, services, licenses and sales should ordinarily be set forth in separately documented transactions. Under regulations adopted by the IRS in August 2006 and consistent with recent changes in the OECD Model Income Tax Convention, the federal tax authorities will apply a risk-based allocation of income and expense between affiliated companies to reflect the economic risks, except as to back-office functions such as administration and accounting. All intercompany transactions thus require some form of documentation, and in some cases Advanced Pricing Agreements with the U.S. and foreign revenue authorities may be useful to avoid “whipsaw”.

- b. Taxation - The States. States impose taxes on the personal and corporate revenue. Many states (including the state of New York) follow the definitions and structure of the federal income tax. Others adopt their own special purpose income taxes. Certain cities impose personal and/or corporate income taxes, including New York City, Philadelphia and Pittsburgh.

- c. Taxes on Personal Income. In general, a foreigner living in the United States for at least 183 days per calendar year (or 120 on average during three years) is considered a resident for federal income tax purposes and therefore must pay U.S. taxes on his global personal income. By means of tax credits, he would only pay the tax at the highest rate of the countries that seek to impose taxation on such revenue.

Under the income tax treaties (see, *for example*, Income Tax Convention between the United States and France, entered into force on August 11, 1968, Art. 15), this rule is softened. Under such treaties (or “conventions,”) salaries and other similar compensation are taxable only in the country in the residence of the service provider, except in the case where the services are rendered outside of such country. In the latter case, the two countries may impose a tax on the personal income, but a tax credit may be given. This being said, the United States may not tax the personal income of a French resident, for example, where:

- the French resident is present in the United States for a period of less than 184 days in the tax year and,
- the compensation is paid to the French resident employee by a foreign

employer, and

- the compensation is not derived from a permanent establishment of the French employer maintains in the United States

Therefore, with a little tax planning, it is possible to avoid submission of or attributable to transitory personnel to the American personal income tax regime.

- d. Taxes on Estates and Successions. U.S. Federal estate taxes expire in 2010 but reprise in 2011. So personal estate tax planning is desirable for entrepreneurs and individual investors. For non-resident aliens investing in the United States, there are several legal ways to avoid the imposition of a federal income tax on estates and gifts in relation to assets (including the shares of corporations established under the laws of a state in the United States) deemed situated in the United States. The same rules apply to taxes on donative transfers (gifts) between living persons.

VIII. Commercial Activities.

Business executives considering the establishment of new business should consider other general commercial laws and regulations. Our law firm can assist you in establishing procedures for legal compliance and to enjoy the benefits of rights allowed under U.S. federal and state laws.

- corporate law, including entity formation and activation, acquisitions, mergers, and strategic alliances and joint ventures.
- international tax law and the tax law involving the states, including contracts for services between affiliated companies and choice of initial locations.
- commercial law, especially matters are relating to contracts for marketing, licensing, manufacturing, distribution and sale.
- outsourcing law, for contracts where another company provides critical services such as information technology management, marketing support (“customer relationship management”), accounting, financial administration or other operational support, to assist your company.
- intellectual property law, to protect foreign intellectual property (such as trademarks, copyrights, patents (through a specialized law firm), trade secrets and know-how) in the United States and to ensure that the subsidiary acquires and protects its rights in the work product generated by its employees and contractors.
- employment law, to define the relationships between employer and employees, to limit the employer’s liability within the law and to provide incentives (such as stock options and bonus compensation) to key employees.

- financial law, including lending, lease-financing and private equity investments.
- insurance law, especially matters relating to products liability for the design, fabrication, sub-contracting warehousing and delivery etc. as well as for the all risk insurance for products such as molds if the manufacturer which is the sub-contractor shall not have provided adequate insurance.
- real estate law (notably, contracts for the interim and long term leasing of office space).
- immigration law.

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This memorandum has been prepared as an introductory outline and not as legal advice. We remain at your service for any further information.

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