CliftonLarsonAllen

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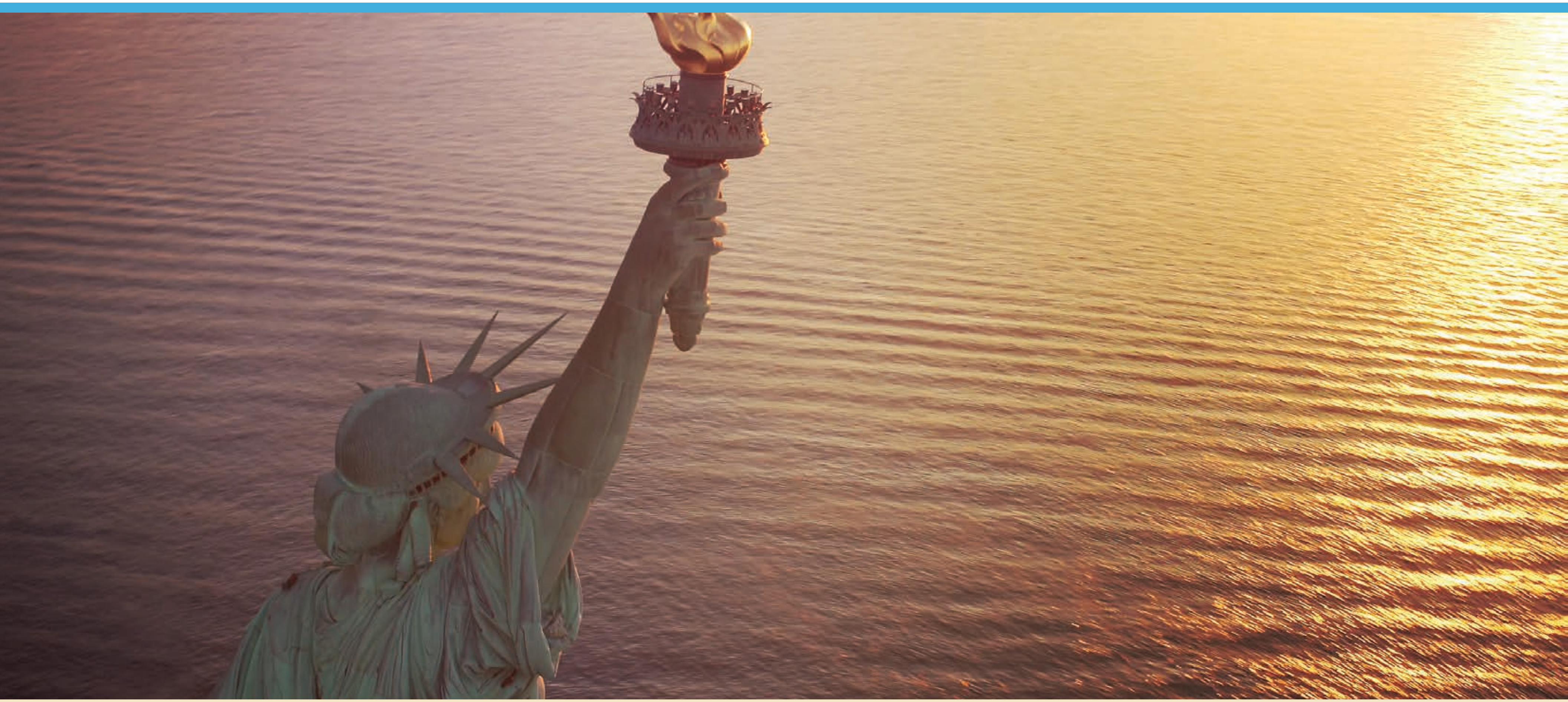
Doing Business in The United States



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Forward

The United States is the world's largest consumer market with a gross domestic product (GDP) of $18 trillion and 325 million people. The business-friendly environment — combined with an educated workforce, cutting-edge technology, and leading supply chain operations — attracts investors and businesses from across the globe. The United States leads the world in research and development, with more international patents than any other country.

In 2017, economic data are positive. In the midst of a rapidly changing international environment, the U.S. economy continues to top all other nations, representing 20 percent of global output.

As the recipient of the greatest volume of foreign direct investment (FDI) in the world, the United States actively works to appeal to foreign investors.

The United States is consistently ranked highly for "ease of doing business." U.S. laws and policies foster entrepreneurial spirit and free enterprise. Investors are attracted to the U.S. for many reasons:

- Stable political and economic environment
- Access to capital
- Skilled workforce
- Incentives by state and local governments
- Protection of intellectual property

At the same time, there are many unique issues to be aware of when doing business in the United States, including:

- Separate federal, state, and local tax structures with their own compliance rules
- Complex employment laws that vary by state and cover independent contractor relationships
- A high demand (and competition) for talent
- Historically low borrowing rate levels — but specific credit relationships may require guarantees from the parent company
- Regulatory compliance, which may include the Securities and Exchange Commission (SEC), Department of Justice (DOJ)/Foreign Corrupt Practices Act (FCPA), and a host of industry regulations

That said, it's the American spirit that drives the economy and its people, who believe they can accomplish anything. Entrepreneurs find a vast amount of resources to start or expand operations in a strong market. "The American Dream" is very much alive and well!

About CliftonLarsonAllen

CLA is a professional services firm delivering integrated wealth advisory, outsourcing, and public accounting capabilities to help clients succeed professionally and personally. Our industry-focused teams support clients locally, nationally, and globally. Established in 1960, CLA has 5,000+ people in 100+ U.S. locations.

We bring a wide array of strategies to help clients in all markets, foreign and domestic. Our Global Concierge[sm] services help organizations successfully enter and compete in all markets. Our professionals are immersed in the industries they serve and have deep knowledge of their operating and regulatory environments. Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor.

CHAPTER 1
Introducing the United States

US Overview	
US Population (US Census Bureau 2016)	323,127, 513 people
Gross Domestic Product (World Bank 2016)	18,57 trillion USD
GDP per capita (World Bank 2016)	57,466.79 USD
Unemployment rate (US Dept. of Labor 2017)	4.2 %

Geography and climate

The United States is the world's third largest country (using land area measurements), after Russia and China. The mainland of the United States stretches nearly 2,800 miles (4,506 kilometers) from the Atlantic Ocean to the Pacific Ocean, and approximately 1,600 miles (2,575 kilometers) from Canada in the north to Mexico in the south. The non-contiguous states include Alaska, which lies northwest of Canada and borders the Arctic Ocean, and Hawaii, located in the Pacific Ocean approximately 2,000 miles (3,219 kilometers) from the mainland. The total area of the United States is 3,679,192 square miles (9,529,065 kilometers).

Due to its size, the United States has examples of nearly every global climate. The climate is mostly temperate, but tropical in Hawaii and Florida, arctic in Alaska, semiarid in the Great Plains west of the Mississippi River, and arid in the Great Basin of the southwest. The main influence on U.S. weather is the polar jet stream which migrates northward into Canada in the summer months, and then southward into the United States in the winter months.

Political system

The United States has a long history of political stability. It declared its independence from the United Kingdom in 1776 and established a constitution-based federal republic that now consists of 50 politically separate states and the District of Columbia (Washington DC), which is the seat of the federal government. The political system is based on a division of powers between the states and federal government.

The Constitution creates a federal government of three separate and equal branches — executive, legislative, and judicial — which is designed to provide a system of checks and balances that prevent the concentration of power in one place.

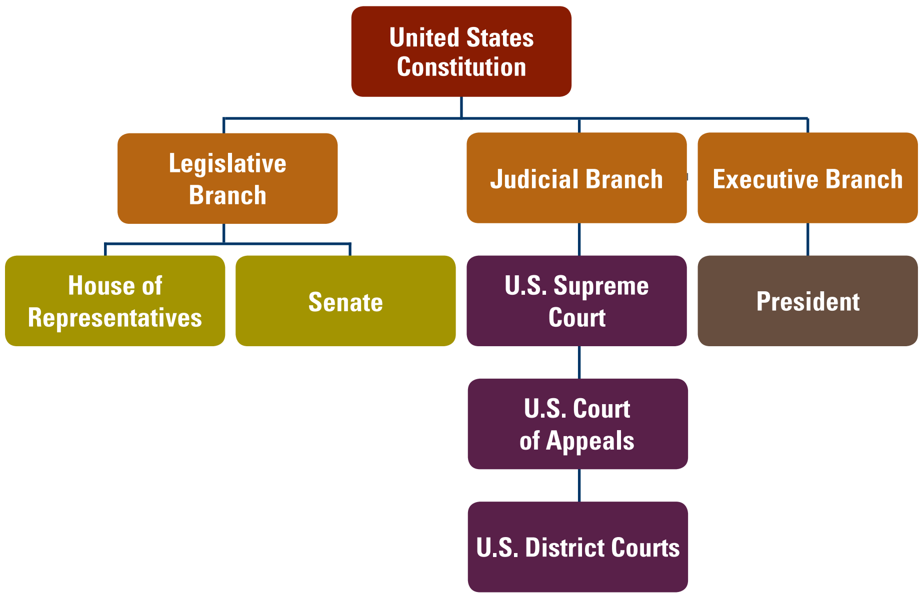
Legislative branch — The legislative branch (Congress) consists of the House of Representatives and the Senate. The House has 435 voting members. Each representative is based on each state's population from the most recent U.S. Census. The Senate has 100 senators (two from each state). The primary role of Congress is to enact laws. The House and Senate have equal legislative powers; there is no "lower" or "upper" house in Congress. Proposed legislation can be started in either chamber.

Executive branch — The executive branch consists of the President, the Vice President, the Cabinet, and federal agencies. The President is both the head of state and the leader of the government. A bill from the legislative branch becomes a law by Presidential signature. The President chooses the Cabinet, and Congress approves his or her nominations. Cabinet positions include: State, Treasury, Defense, Justice, Interior, Agriculture, Commerce, Labor, Health and Human Services, Housing and Urban Development, Transportation, Energy, Education, and Veterans Affairs.

Judicial branch — The judicial branch consists of the Supreme Court and a system of lower courts. The Supreme Court is comprised of the Chief Justice and eight Associate Justices.

CLA is not a law firm and is not authorized to practice law, but we have compiled the following general information from the sources cited at the end of this booklet which we believe will be helpful.

Each state has its own political subdivisions and set of laws governing the conduct of business within its jurisdiction. There are no federal corporate laws. Nonetheless, there are several federal and state regulations that affect foreign businesses in the United States.



Legal system

The U.S. Constitution establishes the Supreme Court and gives Congress the authority to establish the lower federal courts. There are two levels of federal courts below the Supreme Court: the U.S. district courts and the U.S. circuit court of appeals. Each state has at least one district court.

American lawyers are licensed by the states in which they practice law. The United States does not have a federal authority to license lawyers.

The U.S. legal system includes the federal government and the governments of the 50 states. With parallel systems of executive, legislative and judicial branches of government, the relationship can be complex. The Constitution specifically outlines and limits the powers of the federal government. Everything not covered in the Constitution is left to the states.

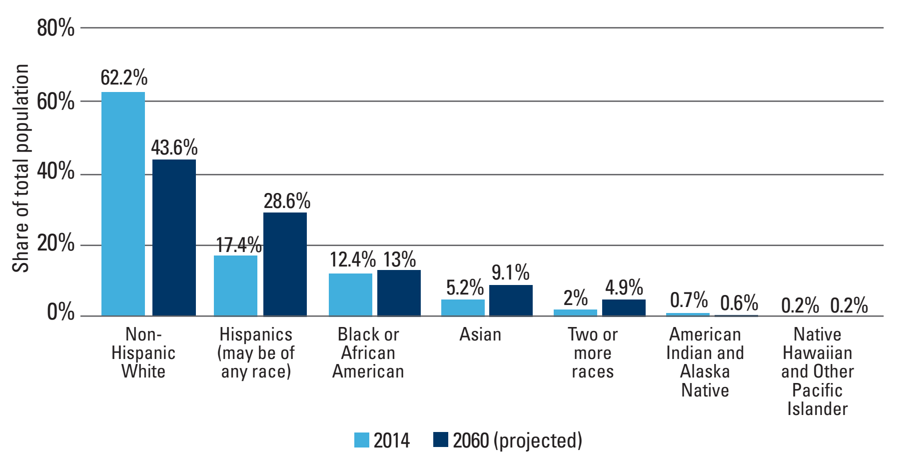
Population

Slightly more than 323 million people live in the United States of America, of which 204 million represent the working age population.

The population is composed of about 74 percent white, 13 percent black, 5 percent Asian, and 1 percent American Indian, Alaska native, Hawaiian native, or other Pacific island native. Another 7 percent are considered two or more races or other races. Hispanics/Latinos make up over 17 percent of the population, but the group is listed separately because the U.S. Census Bureau considers "Hispanic" to mean a person of Latin American descent (including persons of Cuban, Mexican, or Puerto Rican origin) living in the United States who may be of any race or ethnic group.

Immigration will continue to change the face of America. The Pew Research Center projects that by 2065, one in three Americans will be an immigrant or have immigrant parents.

Percentage distribution of population in the United States in 2014 and 2060, by race and Hispanic origin



Language

Although the United States has no official language, English is most commonly spoken. Most governmental functions are in English. Spanish is the second-most widely spoken language. States such as California, Texas, New York, and Florida have growing Spanish-speaking populations.

Economy
The United States has the most powerful economy in the world, with a per capita GDP of $54,800. U.S. firms are at or near the forefront in technological advances, especially in computers; pharmaceuticals; and medical, aerospace, and military equipment.

Availability of natural resources and skilled labor make the United States the leading industrial power in the world. Its highly diversified and technologically advanced industries include petroleum, steel, automotive, aerospace, telecommunications, chemicals, electronics, food processing, consumer goods, lumber, and mining. Besides its industrial strength, Wall Street in New York City is one of the global capitals for finance and investments on a par with London and Hong Kong. The financial services industry in the United States ensures the provision of liquidity and credits for business investments.

In general, U.S. business firms enjoy greater flexibility than their counterparts in Western Europe and Japan in decisions to expand capital plant, to lay off surplus workers, and to develop new products. This greater flexibility leads to lower entrance barriers for foreign firms to the U.S. markets.

United States fiscal policy
The U.S. government has spent more money than it has taken in over the last few decades and has accumulated fiscal deficits in the post-war era. Following the 2008 financial crisis, the U.S. government enacted an expansionary economic stimulus package to pull the economy out of recession. The Office of Management and Budget forecast a deficit of $300 billion – $1.4 trillion per year through FY 2027.

Sixty percent of the government spending is mandatory spending on programs such as Social Security and Medicaid. Nearly half of the income to the U.S. government comes from individual income taxes, with an additional 10 percent from business income taxes. Other sources of income include payroll taxes, Social Security taxes, and excise taxes.

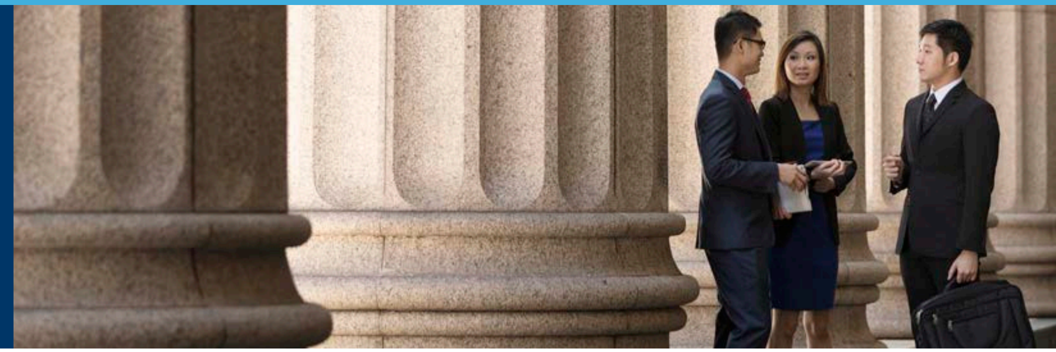
Currency and exchange rate policy
As the most widely used currency in global transactions, the U.S. dollar is often referred to as the world's currency. Across the globe, nearly two-thirds of currency reserves are in U.S. dollars.

Business hours
Standard business hours are typically 8 or 9 a.m. until 5 p.m. However, with four time zones in the country, most businesses remain flexible if needing to do business on both coasts.

Public holidays
The United States recognizes ten federal holidays. Although most states recognize federal holidays, the federal government cannot require them to. In addition, many states recognize other days as state holidays that are not federal holidays. Private employers cannot be required to observe federal or state holidays.

United States Federal Holidays		
Date	**Holiday**	**Notes**
January 1 (fixed)	New Year's Day	Private sector holiday
January 15-21 (floating holiday)	Martin Luther King, Jr. Day	Private sector often doesn't observe
February 15 – 21 (floating holiday)	George Washington's Birthday	Private sector often doesn't observe
May 25 – 31 (floating holiday – falls on Monday)	Memorial Day	Private sector holiday
July 4 (fixed)	Independence Day	Private sector holiday
September 1 – 7 (floating holiday – falls on Monday)	Labor Day	Private sector holiday
October 8 – 14 (floating holiday – falls on Monday)	Columbus Day	Private sector often doesn't observe
November 11 (fixed)	Veterans Day	Private sector often doesn't observe
November 22 – 28 (floating holiday – falls on Thursday)	Thanksgiving	Private sector holiday
December 25 (fixed)	Christmas Day	Private sector holiday

CHAPTER 2
Government Policies and Business Regulatory Environment



Business regulations

The United States is regularly ranked among the top countries internationally for ease of doing business. Benefits include:

- Very few restrictions on foreign ownership of property or businesses
- No government approval required to register a business
- No governmental price control

Bank accounts

After the Patriot Act was signed into law after the terrorist attacks of September 11, 2001, it became more challenging for foreigners to open bank accounts in the United States. This act aimed to fight money-laundering and requires banks to verify all customer information, preferably in person. To open a U.S. bank account, the following items are necessary:

- **Identification —** most banks will require two forms of ID
- **EIN (employee identification number) confirmation letter —** required for all business bank accounts to comply with tax reporting requirements to the Internal Revenue Service (IRS)
- **Proof of address —**most banks will not open a business account without a U.S. physical address
- **Minimum deposit —** the amount will vary from bank to bank

Copyright and intellectual property (IP)

The United States has developed a system of licensing which includes patents, trademarks, and copyrights. The holder of a U.S. patent, trademark, or copyright may sue an infringer through the U.S. court system and also obtain an injunction or sue for damages. A U.S. intellectual property right can be obtained by any person, no matter what the citizenship of that person is.

Patents

Patents and trademark registrations are issued by the Patent and Trademark Office. Any person who invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent. Individual inventors who have obtained a patent can assign or license their rights.

Trademarks

Trademarks relate to any name, sign, design, or expression which identifies products or services of a particular source and distinguish them from others. Trademarks used to identify services are usually called service marks. The trademark owner can be an individual, business organization, or any legal entity. A trademark may be located on a package, a label, a voucher, or on the product itself. Trademarks serve an important role when it comes to brand recognition and corporate identity.

Copyrights

Copyright grants the creator of an original work exclusive right to its use and distribution, for a limited time. Copyrights can be filed with the Copyright Office of the Library of Congress. Works that can be copyrighted include writings, sound recordings, motion pictures, and computer software. For those other than the copyright owner, the use of copyrighted works is permitted when royalty payments are made.

Privacy

The U.S. Federal Trade Commission (FTC) oversees business privacy laws. Specific policies include:

- **Consumer privacy —**The FTC prohibits deceptive practices in the use of consumer data.
- **Children's online privacy —** U.S. law has specific guidelines about online collection of personal information from children under 13.
- **Consumer and employee credit reports —** The Fair Credit Reporting Act ensures businesses maintain the privacy of consumer information included in the files of consumer reporting agencies.
- **Data security and identity theft —** Businesses are required to have a security plan in place to safeguard sensitive personal information about employees and customers.
- **Securing sensitive financial data —** The Gramm-Leach-Bliley Act requires businesses that offer financial products or services to comply with practices to safeguard sensitive data.

Mergers and monopolies

U.S. antitrust laws prohibit business practices that unreasonably deprive consumers the benefits of competition. The U.S. federal government enforces three major federal antitrust laws:

- **The Sherman Antitrust Act —** outlaws all contracts and combinations that unreasonably restrain interstate and foreign trade, including agreements among competitors to fix prices or rig bids
- **The Clayton Act —** prohibits mergers or acquisitions that are likely to lessen competition
- **The Federal Trade Commission Act —** created the Federal Trade Commission to guard against unfair methods of competition in interstate commerce

Import controls

The U.S. Customs and Border Protection Service (CBP) administers import laws and regulations. The majority of permanent imports do not require a license, but they must be declared to U.S. Customs with a description that includes country of origin and tariff classification. Customs then determines the amount of duty to be paid on the import.

CBP is responsible for fixing the classification and value of the goods. When an importer fails to use reasonable care, there can be delays in the release of goods by CBP, and an assessment of fines and penalties up to the value of the goods.

Goods that are imported into the United States are required to be identified and assigned a value. The process of identification is called classification.

Understanding the nature of a specific item lets an importer and the CBP determine the proper tariff rate. The proper tariff code and rate are derived from the Harmonized Tariff Schedule of the U.S. Tariffs differ for each foreign nation. As a consequence, knowing the country of origin lets the importer and the CBP determine which tariff will apply. This is particularly true in the application of free trade agreements.

Export controls

The Commerce, State, and Treasury Departments administer and enforce U.S. export-control laws and regulations. U.S. government authorization, in the form of an export license or license exception, may be required for the export of commodities, software, or technology, including the transfer of controlled technology to foreign nationals in the United States or abroad. The export-control rules also include restrictions on exports to prohibited end users, proscribed end uses, and embargoed or sanctioned countries. The U.S. export regulations have not been enacted for economic reasons only; they were created to prevent acts of terrorism and the proliferation of weapons of mass destruction and restrict the export of commodities, software, and technology that could contribute to the military potential of U.S. adversaries.

Violating U.S. export laws and regulations may result in substantial monetary fines or penalties, seizure or forfeiture of goods, criminal prosecution, greater government scrutiny, negative publicity, and the suspension of export privileges.

Free trade agreements

The United States is a member of the World Trade Organization (WTO) and has free trade agreements (FTAs) in effect with 20 countries. Many are bilateral trade agreements (Australia, Bahrain, Chile, Colombia, Israel, Jordan, Korea, Morocco, Oman, Peru, and Singapore.) Others are multi-lateral trade agreements, like the North American Free Trade Agreement (NAFTA) and the Central America-Dominican Republic Free Trade Agreement (CAFTA – DR).

In order to take advantage of free trade agreements, the rules of origin must be consulted to verify that an import qualifies for beneficial treatment under the free trade agreement.

Consumer protection

Companies doing business in the United States should realize that a broad range of U.S. consumer protection laws applies to any products they produce or sell. In the United States, a variety of federal and state laws regulate consumer affairs. Federal consumer protection laws are enforced by the Bureau of Consumer Protection (a division of the Federal Trade Commission). The majority of states have their own consumer protection laws, and the Bureau of Consumer protection has eight regional offices across the country. In addition:

- The Food and Drug Administration regulates the safety of food, drugs, blood products, medical equipment, transplant tissue, and cosmetics.
- The U.S. Consumer Product Safety Commission was installed to protect consumers from products that pose a fire, electrical, chemical, or mechanical hazard or products that can injure children.
- The Food Safety and Inspection Service ensures the safety of meat, poultry, and egg products regarding correct labelling and packaging.

CHAPTER 3
Banking and Finance

The banking system

Banking in the United States is regulated by both the federal government and the states.

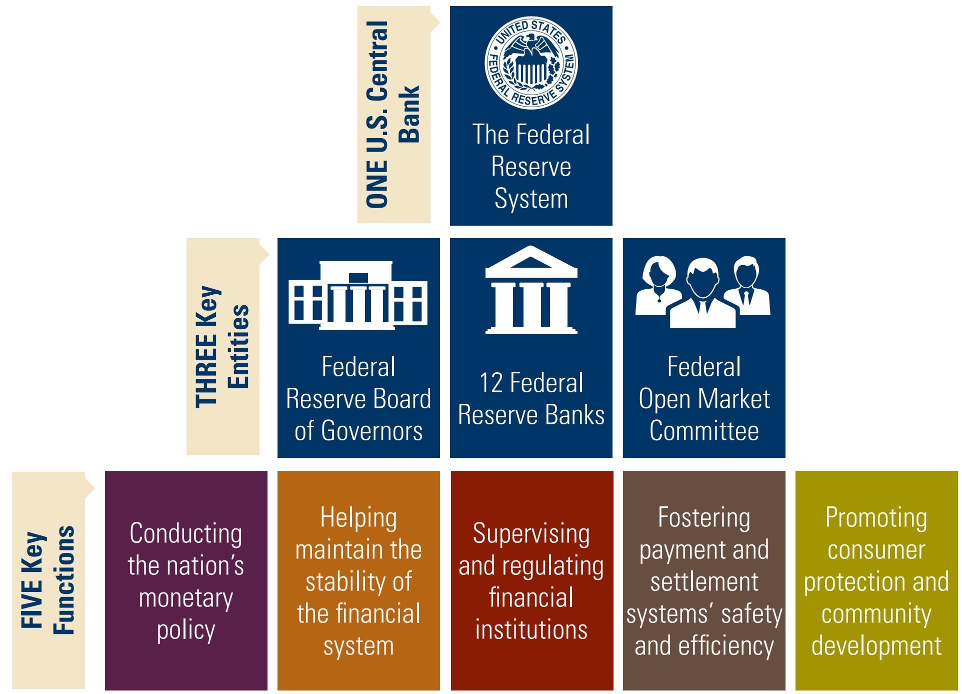
Most U.S. banks are small to medium-sized institutions that operate primarily in their local communities or regions. Examples of large, well-known banks are the Bank of America, Citigroup, JPMorgan Chase, and Wells Fargo. Services typically provided by financial institutions include:

- checking and savings accounts
- cash management, credit, and debit cards
- lines of credit
- business loans
- foreign exchange
- interest rate derivatives
- insurance
- trade finance for international transactions
- asset-based lending/leasing brokerage
- mutual funds and trust services

Federal Reserve System

Unlike banks in many countries, U.S. banks are not government-owned and managed. The Federal Reserve System operates as the central bank of the United States. The Federal Reserve System consists of:

- A central governing body
- A decentralized operating structure of 12 reserve banks
- The Federal Open Market Committee (FOMC)



It has five functions:

- conducts nation's monetary policy
- promotes the stability of financial system
- promotes soundness of individual financial institutions
- fosters payment and settlement systems' safety and efficiency
- promotes consumer protection

Types of banks

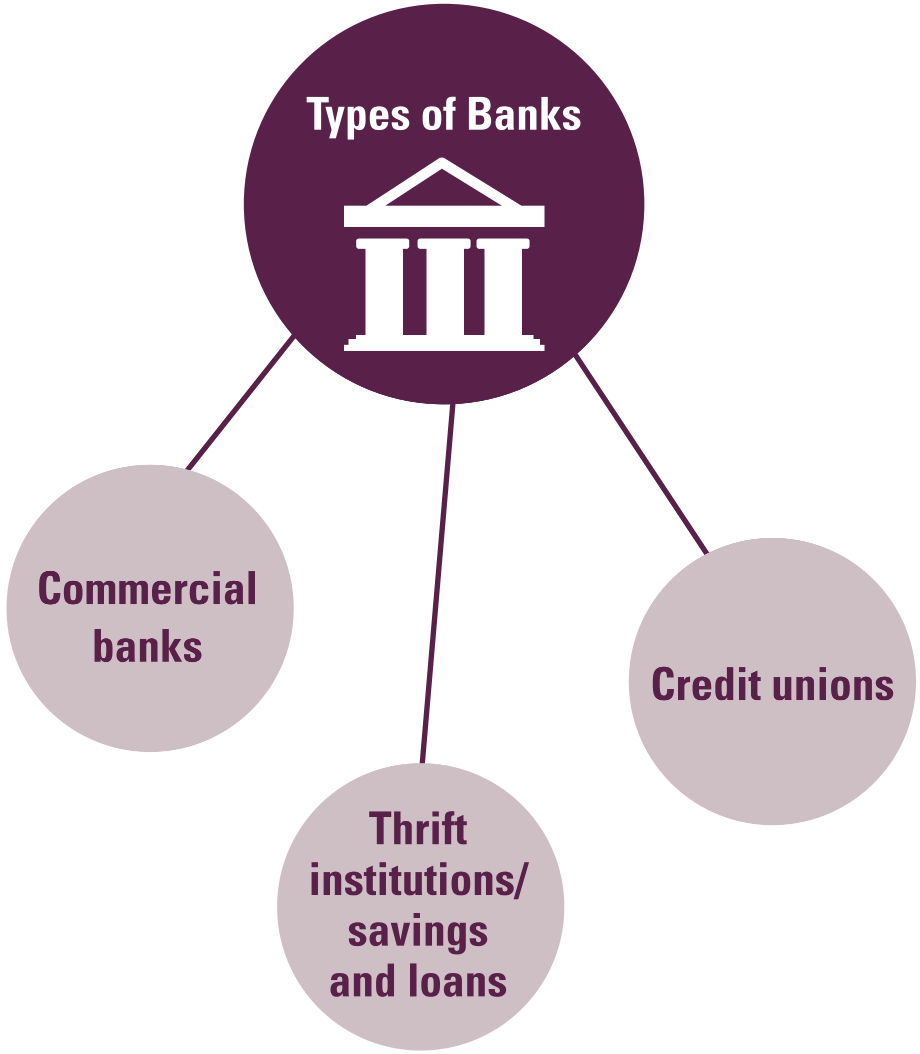
All depository institutions, including national banks, must maintain a reserve of a certain percentage of deposits, set by the Federal Reserve, with the Federal Reserve Bank of their district.

- **Commercial banks** are for-profit businesses that focus on business and individual customers. Commercial banks offer a variety of services, such as taking deposits and making loans. Many have brokerage divisions. Most Americans do their banking at commercial banks.
- **Thrift institutions/savings and loans** originally only offered savings accounts and mortgages. They specialized in real estate lending. Today, they offer all business and consumer services. They can be owned by shareholders or by depositors. The number of thrifts declined dramatically in the late 1980s and 1990s.
- **Credit unions** are non-profit, cooperative financial institutions. Typically, credit union customers share a common characteristic; they work in the same industry or are members of the same community. Most credit unions are federally or state chartered. Credit unions are exempt from federal taxation.

Export-Import Bank

Export financing is provided to domestic and foreign manufacturers by the U.S. Export-Import Bank, which is the official export credit agency of the United States, letting the government subsidizes export financing.

The Ex-Im Bank (as it is known familiarly) offers guarantees, direct loans, discounted loans, commercial and political risk insurance, and importer financing. It supports small-business exports, export-credit insurance, transportation exports, and working capital guarantees. It does not compete with private-sector banks but provides services that private companies are unwilling or unable to provide.



CHAPTER 4
Business Entities

Operating in the United States may be done so through a sole proprietorship, partnership, limited company, branch operation, or a representative office.

The structure chosen should be contingent upon the anticipated size of the U.S. operation, ease of arranging finances, liability exposure, market identification, profit potential, and taxation implications.

A foreign enterprise may operate in the United States through a variety of legal forms, including corporations, general partnerships, limited partnerships, limited liability companies (LLCs), and U.S. branches.

Common reasons to form a separate legal entity include the liability protection accorded by state law to the owners of qualifying entities, and an improved ability to access capital markets for investment capital. Limited partnerships and LLCs often provide more flexibility than other types of entities in permitting preferred returns and other non-traditional profit-sharing relationships. General partnerships afford the same flexibility, however there is potential for personal exposure of the general partner.

Unlike other countries, the United States has no federal company law, as such, the rules regarding the formation, operation, and dissolution of business entities are generally defined by state law rather than federal law. Therefore, careful attention to the specific rules of each appropriate jurisdiction is required.

Sole proprietorship

A sole proprietorship is an unincorporated business owned and run by one owner. There is no distinction between the business and the business owner. Sole proprietorships typically have lower start-up costs and offer control of profits and business decisions. Although this is one of the simplest business structures to establish, it comes with a level of risk. All the debts and liabilities of the sole proprietorship are the responsibility of the business owner. If the business is exposed to a lawsuit, operating as a sole proprietor could put the owner's personal assets at risk.

Corporations

A corporation is a legal form of organization used to carry on a business enterprise. It is recognized by law to be an entity separate and distinct from its shareholders. A corporation has several characteristics, including the ability to hold property, to enter into contracts in its own name, to sue and be sued in its own name, continuity of life, and free transferability of ownership interests. The liability of the corporate shareholders is limited to their investment in the company's stock. Management of the corporation is executed through its board of directors.

Each U.S. state has enacted its own laws regarding the formation and operation of corporations. Although the basic corporate laws are similar, there are differences in certain states that make them favourable for incorporation. The state of Delaware, for example, is known for having well established corporate governance and a liberal approach in regulating corporations, so many corporations organize there. Whereas, other states may impose greater restrictions on corporate activities.

If a corporation operates in more than one state, it will be necessary to register to do business in these additional states in order to have authority for any legal proceedings if required. In any state, the documents necessary to create a corporation may be obtained from the secretary of state's office in the state's capital city. Registration will automatically subject a corporation to nexus implications in that jurisdiction.

The classification of an entity as a corporation for tax purposes is independent from the entity's status under state law. Tax regulations interpreting the U.S. Internal Revenue Code describe an entity as either an "eligible entity" or as a "corporation" under the "check-the-box rules." The entity is treated as an eligible entity unless it is one of the types of entities classified as a corporation. An eligible entity is an entity that meets neither the definition of a trust nor a corporation. Eligible entities can elect corporate status. If no election is made, the entity is treated as a partnership for tax purposes if it has two or more owners, or is disregarded as an entity separate from its owner if it has a single owner.

For tax purposes, there are differences between a C corporation and an S corporation. Under U.S. federal income tax law, a C corporation refers to any corporation that is taxed separately from its owners, whereas an S corporation generally is taxed as a pass-through entity.

Shareholders of a C corporation may elect to treat the corporation as a flow-through entity, specifically an S corporation. An S corporation itself is not subject to income tax. Shareholders of the S corporation are subject to tax on their pro rata shares of income, based on their shareholdings. To qualify for the S corporation election, shares must be held by resident or US citizen individuals or certain qualifying trusts. A corporation may qualify as a C corporation without regard to any limit on the number of shareholders, foreign or domestic.

These C corporations are subject to U.S. tax on worldwide income regardless of where it is earned. A U.S. corporation's earnings are generally subject to double taxation (initially at the company level, and then at the shareholder level) when dividends are received. Dividends are not deductible by the corporation. Dividends paid by a U.S. corporation to non-U.S. persons are subject to 30 percent withholding tax unless reduced by a tax treaty.

Partnerships

A partnership is an association of two or more persons to act as co-owners of a business for profit. It is a legal entity only to the extent that it can own property and can sue or be sued in its own name. A partnership agreement may be either oral or written. However, if the business is to last for more than one year, some states require the agreement to be in a written form.

There are partnership laws in all states, with similarities in the principal aspects of doing business as a partnership, including the rules for determining the existence of a partnership, the relationship of partners to persons dealing with the partnership, the relationship of the partners to one another, the property rights of a partner, and the rules for dissolving and winding up a partnership. In addition, partnerships must comply with local requirements for licenses, permits, and name registration.

Each member of a general partnership has unlimited liability for the partnership's debts, and each partner may be held jointly and severally liable for all partnership obligations. This limits the partnership's ability to borrow funds to the credit of the individual partners. A transfer of a partner's interest in the business may require the approval of the other partners.

A limited partnership is similar to a general partnership in that it is an association of co-owners formed as a business. A limited partnership has at least one general partner and at least one limited partner. The liability of a limited partner is limited to the amount that partner invests in the partnership. The liability of a general partner for the partnership's obligations is unlimited. The limited partnership laws of the several states set out the requirements for creating a limited partnership and establish the members' rights and liabilities. If state laws are not strictly followed, the limited partnership may be considered as a general partnership, exposing the limited partners to unlimited liability for the partnership's obligations.

The articles of partnership are usually a written agreement and must be filed with state officials. This agreement sets out the names of the general and limited partners, the partnership business, the required contributions of each partner, and other general information regarding the partnership and the rights of the partners between themselves. General partners are subject to unlimited liability for the debts of the partnership and are solely responsible for the management of the business. Limited partners may neither take part in the management of the business nor let their names be used in the partnership name. Violation of these rules may cause limited partners to be treated as general partners. Withdrawal of a limited partner usually will not terminate the limited partnership. However, the withdrawal of all general partners will cause the partnership to be dissolved by operation of law.

Limited liability company (LLC)

A limited liability company (LLC) limits owners' liability while maintaining a single level of tax. The default classification of an LLC is a pass-through entity. The LLC offers the advantages of a partnership while excluding some of that liability disadvantages of a GP or LP. For tax purposes, an LLC with more than one member is treated as a partnership, providing all of a partnership's flexibility with the limited liability protection of a corporation. The LLC also may have foreign persons as members. Because LLCs provide significant flexibility for U.S. tax planning, single-member LLCs can serve as divisions of corporations or as owners of sole proprietorships while enjoying limited liability protection.

It is possible to change the tax classification of the LLC to treat it as a corporation through a "check-the-box" election. The tax treatment would then be similar to a corporation.

An LLC with a single foreign corporate owner is taxed as a U.S. branch unless the owner elects to have the LLC taxed as a U.S. corporation under the "check-the-box" rules. A multi-owner LLC is subject to partnership withholding tax rules, unless an election is made to tax the LLC as a corporation.

State tax planning also should be considered with LLCs since their treatment varies throughout the United States. A foreign owner considering use of a U.S. LLC should also think of its tax treatment in the owner's home country, as the LLC is not always considered a pass-through entity under foreign entity classification.

Representative office

A representative office is the easiest option for a company starting to do business in the U.S. The incorporation of a separate legal entity is not required and corporate income tax isn't triggered, as long as the activities are limited in nature. That would include such ancillary and support activities as advertising and promotion, market research, and the purchase of goods on behalf of the headquarters office.

A representative office is most appropriate in the very early stages of a corporation's business presence in the United States. With increasing business activities, it might be necessary to transition into a branch or subsidiary structure.

Branch

A branch structure is similar to a representative office in that it does not require incorporating a separate legal entity. The benefit of having a branch rather than a representative office is that the range of activities can be substantially increased — but it does constitute a taxable presence in the United States and require the annual filing of a U.S. corporate income tax report. A branch may be subject to a U.S. corporate tax rate of up to 35 percent.

The U.S. branch's losses can be offset against the home office's profits. But when the branch is profitable, the parent company may also be subject to tax in the home country on the U.S. profits. A branch structure may expose a disproportionate share of the parent company's profits to a higher U.S. tax rate because attributing the profits to branch activities requires the "arm's-length principle." The risk that intangibles such as intellectual property and brand identity may build up in the United States over time should be kept in mind.

For any structure, an intense review of the given legal conditions in the United States, as well as in the home country, is absolutely necessary to avoid disadvantageous tax and legal issues.

A basic overview of each entity type is outlined below.

Entity Type	Advantage	Disadvantage
Sole Proprietorship	• Low start-up costs • Owner has control of profits and business decisions	• All the debts and liabilities of the sole proprietorship are the responsibility of the business owner; as the entity is not separate and distinct.
Corporation	• Operates as standalone entity • Liability exposure of corporate shareholders limited to investment in company stock	• Each state has different laws regarding formation of corporations • Corporate governance must be adhered to in order to uphold corporate veil • Two levels of taxation: once at corporate level and then on any dividend distribution
Partnership	• Partnership, itself, is not a taxable entity as profits and losses flow through to the individual partners • Structuring flexibility	• Partners may be liable for debts of the partnership
Limited Liability Company (LLC)	• Offers advantages of partnership with additional liability protections • Significant flexibility for U.S. tax planning	• Treatment by U.S. states varies • LLCs are not always considered pass-through entities in a foreign owner's home country
Representative Office	• Easiest option for starting a business in U.S. • Not a separate legal entity	• Increasing business activities might require transition to another structure.
Branch Office	• Range of activities that can be performed is greater than a representative office • Branch's losses can be offset against home office's profits	• Parent company does not have liability protection • U.S. corporate income tax return must be filed • Branch structure may expose disproportionate share of parent company's profits to U.S. tax rate.

CHAPTER 5
Financial Reporting and Audit Requirements

Reporting and audit requirements

Conducting business in the United States requires appropriate recordkeeping methods to properly report business results. Accounting requirements call for full and fair disclosure of the financial condition in compliance with applicable accounting principles, laws, rules, and regulations. When establishing a business within a state, every company must first comply with the state regulations for businesses and the reporting rules and requirements for maintaining correct accounting records.

Tax accounting and reporting

Depending on the type of business organization, the company may choose the accrual or cash method of accounting. Companies with gross receipts less than $5 million generally choose the cash method, while those with more must use the accrual method for U.S. tax reporting. Certain personal service businesses are permitted to use the cash method regardless of their gross receipts. In addition, there are substantial other statutorily required or permitted variances between U.S. tax reporting requirements and U.S. financial accounting standards.

The company will also have to select between reporting on a calendar year or a fiscal year basis. A calendar year is a period of 12 months ending on December 31, and a fiscal year is a period of 12 months ending on the last day of any month (other than December) of the business's choosing.

Statutory audits

A statutory audit is an external review of a business's financial information. It is a U.S. government requirement for certain types of businesses. Private businesses are not required to publicly disclose the results of their financial operations; however, banks or investors may require financial statements. Public companies are required to present annual financial statements to shareholders and comply with the SEC's rules and regulations, including the requirement of an annual audit.

Accounting principles

U.S. Generally Accepted Accounting Principles (GAAP) are used in the preparation of general-purpose financial statements adopted by the U.S. Securities and Exchange Commission (SEC).

The SEC requires that U.S. domestic public companies report under GAAP. Foreign private companies may report under GAAP or International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

Consistency throughout each reporting period and among succeeding periods is one of the core accounting principles. Any changes to the application of accounting principles must be explained with the cumulative effect adjustments presented in accordance with GAAP.

Certain assets are measured at historical cost and others are measured at fair value, such as marketable equity securities and other financial instruments in which GAAP allows for a fair value option. Tangible long-lived assets, such as property, plant, and equipment, are subject to depreciation adjustments that would allow the financial statements to reflect the asset's original cost, less accumulated depreciation. There are tax guidelines that specifically provide for the various methods of depreciation of assets over their respective economic lives, as defined by the IRS. These guidelines provide for various accelerated methods of depreciation that must be applied to the basis of the assets.

GAAP does not allow a fair value option for property, plant, and equipment. Long-lived tangible assets must be evaluated for impairment whenever a triggering event occurs. If the impairment values are less than the assets carrying amount, the asset is written down to its fair value and an impairment loss is recognized.

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The scope of the definition and guidance applies broadly to fair value measurements encountered in GAAP, both financial and non-financial. GAAP also provides for a formal hierarchy for measuring and evaluating fair value estimates.

Financial reporting

Financial statements prepared in accordance with GAAP include a balance sheet, income statement, statement of stockholders' equity, and a statement of cash flows. Balance sheets reflect the status of the company's assets, liabilities, and retained earnings at a specific date and time. Income statements reflect the results of business operations for a specific period of time.

Private companies are not required to have their financial statements audited, but public companies must have an annual financial statement audit conducted by an independent certified public accountant (CPA). However, it is a common practice that a company's banks or investors require financial statements to be audited, reviewed, or compiled. The auditor's opinion states that the information contained in the financial statements present true and fairly, in all material respects, the financial position, results of operations, and cash flows in accordance with GAAP.

Audits of public companies are conducted in accordance with standards of the Public Company Accounting Oversight Board (PCAOB). Audits of other organizations are conducted in accordance with Generally Accepted Auditing Standards (GAAS) that are issued by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA).

CHAPTER 6
Entity Taxation

In the United States, Congress and the President are in power for writing and approving federal tax law. The Department of the Treasury issues regulations that interpret tax law. The Internal Revenue Service (IRS) enforces tax laws, collects taxes, processes tax returns, and issues tax refunds. Various agencies within the Customs and Border Protection Agency are responsible for the enforcement of trade and tariff laws and duty collection.

The United States has one of the most complex tax systems in the world. In addition to federal tax authorities, there are state and local government agencies enforcing their own jurisdictional laws in cooperation with federal regulators. The tax burden of an entity or individual depends decisively on the jurisdiction in which it operates and earns taxable income.

Every person, organization, and company in the United States is subject to income taxation. Income must be reported, and taxes must be calculated and paid annually. Exempt organizations are even required to file a return.

The specific tax regime applied to an entity depends on the specific entity type and business engagement in the United States.

Domestic entities

Domestic entities include C corporations and pass-through entities.

Domestic C corporations

A C corporation organized or created in the United States is a domestic corporation, while all corporate entities organized outside the United States are considered foreign, except for certain corporations that have expatriated from the country. C corporations are treated as separate tax-paying entities, independent of and generally unaffected by the composition and characteristics of their shareholders. Unlike other business entities, such as partnerships or single-member limited liability companies, corporations are taxed on their net income at graduated rates up to 35 percent.

Apart from certain special classes of corporations, the determination of applicable tax rate is computed based on taxable income. Taxable income begins with gross income, increased and decreased by various items. To calculate taxable income, corporations are subject to special rules regarding the timing and deductibility of certain types of expenses, as well as available accounting methods. Corporations are penalized on the accumulation of profits, and earnings are generally subject to two levels of taxation: once at the corporate level, and then, upon distribution, again at the shareholder level.

C corporations tax implications

U.S. corporations must pay tax on income they generate, regardless of location, including income from branches, whether or not repatriated. A branch is considered operations of the U.S. entity outside of the United States — not those conducted through a separate legal entity formed in the foreign country of operation. Any income generated in the foreign country (including income from a business, compensation for services, fees and commissions, rents, royalties, interest, dividends, gains from dealings in property, and income from a partnership) are reported on the U.S. corporate tax return. U.S. corporations and their foreign branches must pay U.S. federal, state, and local tax on their income.

Domestic pass-through entities

Domestic pass-through entities include limited liability companies, general partnerships, limited partnerships, and limited liability partnerships.

- **Limited liability companies (LLC)**
  - LLCs are hybrid entities that combine the pass-through tax attributes of partnerships with the corporate characteristic of limited liability. The members of an LLC have limited liability and are personally protected from the company's liabilities. They may actively participate in the management of the business without losing the protection of limited liability under state law (which governs the LLC regulations). By default, LLCs are treated as pass-through entities. There is potential to make an election to treat an LLC as a C corporation for tax purposes if there is a specific business reason to do so.

- **Partnerships (general, limited, or limited liability)**
  - As explained in Chapter 5, each partnership type has a different legal structure and liability implications. However, the tax treatments for all partnerships are generally the same, notwithstanding passive and non-passive income attributions.
  - Each member of a general partnership has unlimited liability for the partnership's debts, and each partner may be held jointly and severally liable for all partnership obligations. Limited partners are generally not liable for partnership obligations; their risk is essentially limited to their agreed capital contribution and any recourse debt, unless the partnership agreement states otherwise. For instance, to the extent a limited partner is vested with or delegated management powers or duties under the partnership agreement, the limited partner owns the same fiduciary duties as a general partner and is subject to the same standards and limitations with respect to the exercise of such powers or duties. Under these stipulations, a limited partner could lose protected limited partner status and become liable for risk. The partnership agreement may set forth terms that allow the limited partners to have voting rights in order to make decisions for the partnership. Therefore, the partnership agreement becomes an important governing tool and should set out parameters of limited and general partner responsibilities.
  - There are various ways partners can acquire an interest in a partnership under the non-recognition rules of IRC Section 721 without triggering a taxable event. The most common methodologies are either a contribution of capital (tangible or certain intangible) in exchange for an equity interest in the partnership ("equity partner") or a contribution of services in exchange for a profits only interest in the partnership ("income partner"). An income partner has no capital interest in the partnership. It is possible for a partner to contribute services to a partnership in exchange for a capital interest; however, this triggers a taxable gain upon such acquisition of interest.
  - The equity versus income partner distinction becomes important upon liquidation or sale of the partnership, as the capital interest each partner holds at that time dictates their respective share of distributions upon such event (liquidation of the partnership).
  - For partners, remuneration from the partnership is received via distributions. Distributions from the partnership are generally tax-free in the United States if the partner has sufficient "basis" in the partnership interest of the entity.
  - "Basis" is a well-established US tax principle pertinent to pass-through entities. In essence, a partner's basis in an entity is computed in relation to their fixed capital, plus profit allocation, less any distributions made or losses allocated during the lifetime of that member's interest. If a partner's basis goes below zero during the duration of the partnership as a result of a distribution, such partner may be taxable on capital gain income equal to the value of the negative basis.
  - This ordinarily gives rise to a single-layer of taxation at the partner level.

Pass-through tax implications

A partnership is a flow-through entity, meaning it is transparent with no federal income tax assessed at the entity level. The partners are responsible for paying tax on their allocable share of the net profit generated by the partnership during the year. The partnership's income and expense items retain their tax characteristics and source when recognized by the partners. The partners are liable for tax on the income arising from their profit share each year, whether this income is distributed or retained within the business.

For tax reporting, each partner will be issued Schedule K-1, reporting his or her share of income and expenses. The partner will be subject to federal, state, local (if applicable), and self-employment tax (when relevant) on the income reported on Schedule K-1. Remuneration is paid by way of allocable distributions based on net profit. Distribution amounts are not taxable income to the extent they do not exceed the partner's basis in the entity.

Foreign entities

For non-U.S. businesses operating in this United State, there are several unique requirements and circumstances that create a range of tax obligations, based upon the U.S. Internal Revenue Code (IRC) and related regulations.

Foreign corporations, branches, and partnerships are taxable in the United States only on their fixed, determinable, annual or periodic (FDAP) income or on effectively connected income (ECI) they create.

Fixed, determinable, annual or periodic (FDAP) income

FDAP income is generally considered to be passive income generated from U.S. sources. FDAP income includes dividends, interest, pensions, royalties, and real property income such as rents and royalties. Capital gains are not considered to be FDAP income, unless the capital gain arises from the sale of real property located in the United States. Capital gains refer to a profit that results from a disposition of a capital asset such as bond, stock, or intangible asset, where the amount realized exceeds the purchase price.

Withholding taxes on FDAP income

U.S. source FDAP income is generally subject to a 30 percent U.S. withholding tax when distributed to the foreign beneficiary. However, under applicable tax treaties, the rate of U.S. withholding can be greatly reduced. Tax on FDAP is withheld at the source on a gross basis at a 30 percent statutory rate.

Administration of FDAP income

The foreign person should complete the relevant Form W8 (BEN-E, IMY, ECI, EXP) to signify if he or she is entitled to treaty tax rates and provide it to the U.S. entity. This will allow the U.S. entity to apply the relevant tax withholding rate when making any FDAP payments to the foreign person. The U.S. entity is then responsible for filing Form 1042/1042S and providing it to the foreign person. Form 1042 will detail the reportable and taxable FDAP income for the calendar year. If the correct withholding rates are applied to the FDAP payments and correctly reported on Form 1042, the foreign person has no additional U.S. tax reporting obligation.

Permanent establishment implications

As a general principle, U.S. tax laws seek to impose a tax on every company that is considered to be doing business in the country. Therefore, if a foreign entity has business activity in the United States, there is potential this activity could be taxable in the United States. The Permanent Establishment Treaty clause could be used to mitigate U.S. tax exposure on activity. Most U.S. income tax treaties exempt resident companies and individuals of other treaty countries from U.S. federal taxation on business profits if they do not have a permanent establishment (PE) in the United States.

If the foreign corporation is resident in a country that has an applicable income tax treaty with the United States, it will generally only be subject to U.S. tax on its profits attributable to a U.S. PE. The nature and amount of activities that would lead to a foreign company being engaged in a U.S. trade or business are more extensive than those that would create a U.S. PE. In general, a PE requires a stable or permanent business connection with the United States.

A U.S. PE is defined as a fixed place of business in the United States through which the foreign enterprise carries on its business. However, a foreign enterprise will not be deemed to have a U.S. PE if its activities in the United States are limited to certain activities, especially those of a preparatory or auxiliary nature. A foreign enterprise will also be considered to have a U.S. PE in respect to activities undertaken on its behalf by a dependent agent who has and habitually exercises an authority to conclude contracts in the United States that are binding on the foreign enterprise. A foreign enterprise will not be deemed to have U.S. PE merely because it carries on business in the United States through a broker, general commission agent, or any other agent of an independent status, provided that such person is acting in the ordinary course of his business as an independent agent.

It should be noted that in cases where the PE provisions of a treaty apply and the income of the corporation would not be subject to U.S. taxation, an annual tax return to report the treaty position may be filed as a protective position.

Effectively connected income (ECI)

When a foreign entity actively engages in a trade or business in the United States during the tax year, all income from sources within the United States connected with the conduct of that trade or business is considered to be effectively connected income (ECI). Whether an entity is engaged in a trade or business in the United States depends on the nature of the activities. For example, performing personal services in the United States is usually considered an engagement in U.S. trade or business. But just trading in stocks or securities through a U.S. resident broker or other agent is generally not. Case law provides clarification based on measurement of the owner's level of activity and specific facts and circumstances. Typically, the business must have a profit motive, and activities must be "considerable, continuous, and regular." Isolated activities usually do not rise to the level of a trade or business. However, an agent's activities in the United States may result in U.S. trade or business.

When a foreign corporation is deemed to be engaged in a U.S. trade or business and generating ECI, the foreign corporation essentially has created a branch of its operations in the United States and must file a foreign corporate tax return to report such income. A branch of a foreign corporation is taxed in the same way as a domestic corporation on income that is effectively connected to its U.S. operations. There will be tax due on the income at the standard corporate income tax rates.

The assessment of income tax is largely based on the branch's records, assuming they reflect an "arm's length" relationship between the branch and the head office. Expenses to be deducted must be allocated between the branch and its head office. Branch profits remitted to the head office are subject to a 30 percent branch level tax, unless that rate is reduced by an applicable treaty.

A deduction is permitted for all ordinary and necessary expenses paid or accrued during the tax year in connection with the operation of a trade or business. Items that are not tax-deductible include going concern value, expenses related to tax exempt income, political contributions, costs for certain types of life insurance, legal penalties, and costs related to corporate restructurings.

A reasonable deduction for the exhaustion of property used in a trade or business or to produce income is allowed. Depreciation is permitted on tangible property, except inventory, stock in trade, land, and certain natural resources. Depreciation is also permitted on intangible assets with limited useful lives like patents or copyrights. The cost of acquired intangible assets (such as goodwill or trademarks) can be amortized over 15 years from the date of purchase.

To avoid double taxation on income earned outside the United States, a foreign tax credit is available for foreign income taxes paid. The extent to which a foreign income tax credit may be used to offset the U.S. tax is subject to various limitations.

ECI tax rates

ECI is taxed at graduated rates that apply to U.S. corporations: 34 percent for companies with taxable income of more than $75,000 and less than $10 million, up to a 35 percent minimum rate on net taxable income of more than $10 million for federal tax purposes.

In addition to the federal tax liability, U.S. income can be taxed at the state and local levels. State tax rates vary from 0 percent to 13 percent, but the state income tax paid is deductible for federal income tax purposes. Because of the possibility of multiple taxation at federal, state, and local levels, the U.S. effective marginal tax rate can reach between 38 percent and 40 percent.

Branch taxes

A foreign corporation, partnership, or investor that engages in a U.S. trade or business and generates ECI is not only subject to tax on its ECI, but also is subject to branch taxation, including branch profits tax, branch-level interest tax, and branch tax on excess interest.

Similar to the tax treatment of a corporation that issues dividends, the branch profits tax treats a U.S. branch of a foreign corporation as if it were a U.S. subsidiary that pays a dividend equal to its U.S.-based profits that are not reinvested in the U.S. branch. The "deemed dividend" amount is subject to a 30 percent tax. This amount is referred to as the dividend equivalent amount; it is defined as effectively connected earnings and profits from a U.S. source, increased by net decrease in U.S. net equity, and decreased by net increase in U.S. net equity. In this context, U.S. net equity is the sum of the assets connected with the U.S. branch, less the liabilities. The tax base is essentially the branch earnings for the year reduced by the amounts reinvested in the United States.

The branch-level interest tax treats interest paid by a U.S. branch of a foreign corporation as if it was paid by a domestic corporation. These interests are subject to 30 percent U.S. withholding tax. Furthermore, a tax on the excess of the amount of interest deductible by a foreign corporation over the amount of interest treated as paid by U.S. branch may be imposed. A foreign corporation must compare the amount of interest allowed as a deduction in computing effectively connected income to the amount of interest paid by the branch. The excess is treated as if it were interest paid by a completely owned domestic subsidiary to the foreign corporation, thus subjecting it to 30 percent withholding.

Exemptions or reduced branch-tax charge rates can apply under relevant income tax treaties. The dividend treaty rates for the country in question should be utilized to determine the relevant branch-profits treaty rate to apply.

Tax administration

In the United States, all taxpayers are required to compute their own tax liability for the tax period in a self-assessment system. Entities will have to select between reporting on a calendar year or a fiscal year basis.

A calendar year is a period of 12 months ending on December 31, and a fiscal year is a period of 12 months ending on the last day of any month other than December.

For calendar-year corporate taxpayers and fiscal-year taxpayers other than 30 June, the annual corporate tax return is due by the 15th day of the fourth month after the close of the company's tax year. An extension is permitted to move the filing due date out six months. For fiscal-year 30 June corporate taxpayers, the annual corporate tax return is due by the 15th day of the third month after the close of the tax year. A seven-month extension is permitted. Generally, the corporation's tax liability must be paid through quarterly installments during the year the income is earned. These estimated payments are due on the 15th day of the fourth, sixth, ninth, and twelfth months of the company's fiscal year.

Foreign corporate tax returns are due on or before the 15th day of the sixth month following the close of the tax year. A six-month extension is possible. Estimated tax payments are required on a quarterly basis. Foreign corporations with U.S. income must adhere to these deadlines.

Partnership tax returns are due by 15th day of the third month after the close of the company's tax year. A six-month extension is permitted. There is no tax due on the Federal Form 1065. With Form 1065, Schedule K-1s are also produced, which detail each partner's profit allocation for the year. The Schedule K-1 is used by the partner in order to prepare his or her U.S. income tax return.

After a return is due or filed, the IRS has three years to make tax assessments. That particular date also is referred to as the statute expiration date. The statute of limitations limits the time taxpayers have to file a claim for credit or refund as well.

Tax returns may be examined in an audit. An audit is an IRS review of an individual's, partnership's, or corporation's accounts and financial information to ensure information is being reported correctly and to verify if tax reported on the tax return is precise. After the examination, if any changes to the tax are proposed, the taxpayer can agree with the changes and pay any additional tax owed or disagree with the changes and appeal the decision.

Tax treaties

The United States has income tax treaties with more than 60 foreign countries, providing substantial benefits by reducing or eliminating the 30 percent withholding tax on U.S. source income. The exemption from paying tax does not necessarily exempt the foreign person from filing applicable tax returns. Under the U.S. Constitution, treaties and laws passed by Congress have equal authority and are supreme law. U.S. case law presumes that precedence is given to the most recently enacted authority. The U.S. Congress is able to enact laws overriding existing U.S. treaty commitments. It has to be considered that treaties do not govern taxation by individual states.

To avoid abuse of treaties, the United States has limited preferential treaty rates to residents of a treaty country that satisfy the three conditions of economic nexus, economic ownership, and tax ownership.

To have an economic nexus the resident must have a sufficient relationship with the treaty country to verify that it is not using the country to obtain advantages in taxation. Economic ownership means the resident of the treaty country must economically, respectively, and beneficially own the income. To meet the criteria of tax ownership, the resident must be subject to tax on the income imposed by the treaty country.

Transfer pricing

Transfer pricing regulations govern how related party entities set internal prices for the transfers of goods, intangible assets, services, and loans in both domestic and international contexts. The regulations are designed to prevent tax avoidance among related entities and place a controlled party on par with an uncontrolled taxpayer by requiring an “arm’s length” standard.

The arm’s length standard generally is met if the results of a controlled transaction are consistent with results that would have been realized if uncontrolled taxpayers had engaged in a similar transaction under similar circumstances. If a company is not in compliance with the arm’s length standard, the IRS may increase taxable income and tax payable in the United States. After a transfer pricing adjustment, a multinational company may face double tax, paying tax on the same income in two countries. Multinational companies may request competent authority relief from double taxation through a tax treaty.

The arm’s length standard is applied by comparing transactions between associated parties (“controlled transactions”) with transactions between independent enterprises based on economically relevant characteristics. Comparability is achieved if:

- No differences between the controlled and uncontrolled transactions exist
- The differences that do exist do not materially affect the condition being examined
- Reasonably accurate quantitative adjustments can be (and are) made to eliminate the effect of any differences.

The regulations set forth a transfer pricing methodology (TPM) that is used to test whether a transaction meets the arm’s length standard. Taxpayers may rely on these regulations to help them establish acceptable transfer prices.

The best method rule is used to select the applicable method for testing the arm’s length character of a controlled transaction. The best method rule favors the method that provides the most reliable measure of an arm’s length result. In the United States, no one method is favored over the other. Reliability is dependent upon the degree of comparability between the controlled transaction and uncontrolled transaction, as well as the quality of the data and assumptions used in the analysis.

The regulations specify six transfer pricing methods for controlled party transactions. The methods can be categorized into the following three classifications:

- Simplified cost method (SCM)
- Traditional transactional methods
- Profit-based methods

The six methods as set forth in the regulations are:

– Service cost method
– Gross services margin method
– Comparable profits method
– Comparable uncontrolled services (CUS)
– Cost plus method
– Profit split method

Analyzing the controlled transactions in connection with these methodology guidelines will be the basis for the transfer pricing charge between the related parties.

To avoid potential transfer pricing penalties, one avenue available to companies may be to obtain an advance pricing agreement (APA) with the IRS, unilaterally, or with the IRS and another tax authority, bilaterally, covering inter-company pricing.

States’ direct taxation

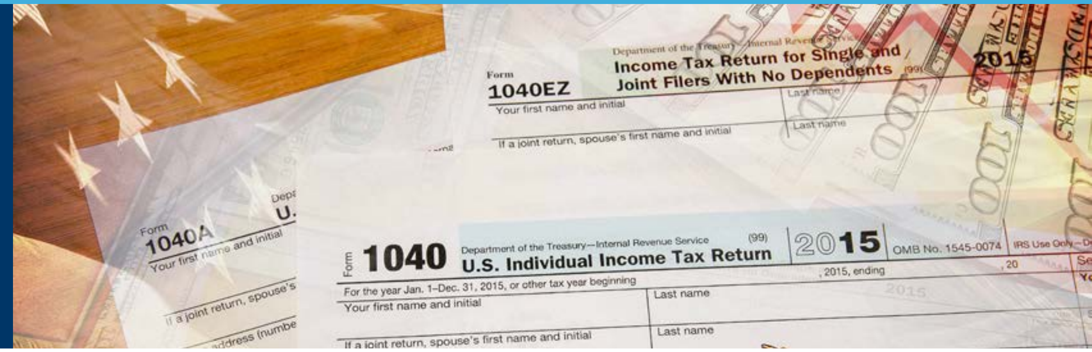
Nexus

State income taxes are imposed on entities that have “substantial nexus” with that state. Each state levies different types of taxes (including franchise, property, sales and use, and employment taxes) and has different stipulations as to what constitutes nexus.

For example, considerations can be based on the presence of tangible property or employees within a state, or from transacting business within a state through an agent, employee, or other means (physical nexus). Additionally, if business within a specific state becomes significant, economic nexus can be created, even without having an actual physical presence in that state. There is no standard regulation for all states, so each transaction scenario must be examined on a state-by-state basis and continually be assessed, especially if business circumstances or operations changes.

- Physical nexus
  - Nexus is created if a company maintains a temporary or permanent presence in a state. Permanent presence may consist of people (employees, service people, or independent sales/service agents) or property (inventory, offices, or warehouses). Temporary presence may be created through solicitation of customers or prospects, trade show attendance, or consigned inventory in warehouses.
- Economic nexus
  - Historically, the physical presence of tangible property, employees, or agents within a state has been enough to establish a connection sufficient to justify the imposition of state tax. But recently the concept of an economic presence nexus has become prevalent such that, in cases where a taxpayer has no physical presence in the state, that state may still determine that entity to have derived significant economic value from in-state activities and impose state tax.
  - Economic nexus could be deemed to exist between a state and a company based on the presence of intangible property in that state. For example, the license of trademarks to a company located in a state could be said to create nexus for the out-of-state licensor on the basis that the intangibles are present in the state. A factor presence standard establishes nexus based on a certain level of sales activity into a state, even in the absence of physical presence in the state. Certain states have enacted "brightline" economic presence thresholds to determine if sales from within the state create economic nexus for the entity.
- Agency nexus
  - Agency nexus may be established through the activities of an employee or independent contractor, or even through a business relationship with another entity. This is more often seen with the use of independent contractors marketing a taxpayer's product; these contractors may be soliciting sales which provide a significant benefit to the business sufficient enough to impose a tax obligation.
  - As such, the use of an independent contractor should be restricted to the mere solicitation of sales, and the contractor should not be permitted to pursue any activity which may further the business of an out-of-state corporation.

CHAPTER 7
Personal Taxation



Residents and non-residents

Tax rates and laws vary depending on an individual's residential status in the United State. Residents and non-residents fall into these categories:

- U.S. citizen
- U.S. green card holder
- Resident alien
- Non-resident alien
- Non-immigrant
- Non-immigrant visas
- Visa waiver program

U.S. citizen or green card holder

U.S. citizens and green card holders are required to file U.S. income tax returns every year, regardless of where they reside.

Resident alien

For income tax purposes, a non-U.S. citizen is considered a U.S. tax resident alien if he or she meets certain day count tests, specifically the Substantial Presence Test (SPT), in any given year.

The SPT counts the days the individual is physically present in the United States. If an alien is physically present in the United States on 183 days or more in the calendar year, he or she is a resident alien for that year. To this extent, the SPT is similar to the 183-day test that is applied for tax residency purposes under the laws of many U.S states and by many foreign countries. However, the 183-day test is broader than the SPT; it applies a "lookback" rule that can classify an alien as a resident alien even if he or she spends fewer than 183 days in the United States during the calendar year.

The "lookback" test is applied as follows: If an alien is present in the United States on at least 31 days of the current calendar year, he or she will (absent an applicable exception) be classified as a resident alien if the sum of the following equals 183 days or more:

1. The actual days in the United States in the current year, plus
2. One-third of his or her days in the United States in the immediately preceding year, plus
3. One-sixth of his or her days in the United States in the second preceding year

Therefore, for a non-U.S. citizen to determine U.S. tax residency, it is imperative to track all days of presence each year, as an individual's residency status can change from year to year.

Non-resident alien

One who has not passed the green card or substantial presence test is considered a non-resident alien. The following non-resident aliens are required to file a tax return:

- A non-resident alien who has participated in U.S. trade or business transactions throughout the year
- A non-resident alien who has not participated in U.S. trade or business transactions but has fixed, determinable, annual, or periodic (FDAP) income
- Representatives or agents responsible for filing the return for non-resident aliens described above (1 and 2)
- A fiduciary for a non-resident alien or trust
- A resident or domestic fiduciary who takes care of an individual or property of a non-resident alien may be subject to filing a tax return

Non-resident aliens are only taxed on U.S.-sourced income. Specifically, in determining whether a particular item of income is potentially subject to U.S. tax, the IRC relies heavily on the term “source of income.” U.S.-sourced income is gross passive income arising from assets located in the United States or income effectively connected with the conduct of a trade or business within the United States, which refers to income that is taxed at graduated rates because it is attributable to U.S. business activities.

Gross income from sources within the United States is potentially subject to U.S. tax. Gross income from sources outside the United States, however, is never taxed on a U.S. non-resident income tax return unless it is considered income effectively connected with a U.S. trade or business.

Income tax

U.S. citizens and U.S. resident aliens are taxed in the same manner. The federal and state governments enforce a tax on annual income. This tax requires all individuals to file a tax return annually.

U.S. persons are subject to tax on worldwide income and required to report to the IRS all information with regard to the entities and assets they hold both in, and in particular, outside the United States. Any income earned while a U.S. tax resident, regardless of situs, is reported and taxed on a resident income tax return. This includes, but is not limited to, all compensation, investment income, rental income, and bonus payments.

Income for individual tax reporting purposes includes wages, dividends, pension payments, interest, profits on investments, and the like. Taxes on the wages paid to an individual are deducted by the employer, withheld, and sent directly to the respective taxing authorities. But because U.S. tax brackets are graduated rates instead of flat rates, individuals complete and file a tax return to ensure final tax liability is equal to what was withheld. Any overages are paid back as a refund, while insufficient withholdings are covered by a payment by the individual to the taxing authority along with the return.

The filing date for individual taxpayers is 15 April or 15 June. A six-month extension to file the return can be requested.

The U.S. tax year for individuals generally is the same as the calendar year (1 January to 31 December).

Individual income tax returns are due on the 15th day of the fourth month after the end of the tax year (in particular 15 April) unless that day is a Saturday, Sunday, or federal holiday, in which case the return is considered on-time if filed on the next business day.

Calculating compensation income

Gross income includes wages, salaries, sales commissions, compensation computed as a percentage of profits, insurance premium commissions, tips, bonuses, termination or severance pay, rewards, jury fees, marriage fees, and clergy compensation.

Employee share scheme

Special rules apply to certain stock options acquired by an employee.

Some employees receive stock options in connection with the performance of their services. If the stock option is either non-transferable or subject to a substantial risk of forfeiture, the amount and timing of gross income depend on whether the fair market value of the option is readily ascertainable. If it is, the employee includes the excess of the fair market value of the option in gross income when it substantially vests over any amount paid for the option. If the fair market value of the option is not readily ascertainable, the employee includes the excess of the fair market value of the option in gross income when it is exercised or disposed of over any amount paid for the option.

There are other types of tax-favored stock options (incentive stock options and employee stock purchase plan options) which have complex taxing regimes. The point of taxation for these plans vary from grant, exercise, and sale date, depending on the specific plan details.

Other income

Generally, any income earned through investment activity, rental property, any other business or trade is reportable and taxable for U.S. income tax purposes. Some examples include interest income, dividends, royalties, rental income, sale of stocks and securities, personal trade or business, and alimony income.

Deductions

There are two main types of deductions: standard deductions or itemized deductions. An individual must pick one or the other and cannot claim both.

Standard deduction	Itemized deduction
A dollar amount set by the IRS that one can deduct against their taxable income. These dollar amounts are adjusted for inflation annually and vary based on the type of taxpayer you are (single, married filing separately, married filing jointly, or head of household).	Detailed out within your tax return and include the following: • medical expenses • gifts to charity • real estate expenses • theft or casualty losses • state taxes similar to income or sales taxes (cannot deduct both) • miscellaneous deductions

Personal tax rates

The federal income tax has seven different rate levels, or tax brackets, depending on the amount of income earned:

- 10 percent
- 15 percent
- 25 percent
- 28 percent
- 33 percent
- 35 percent
- 39.6 percent

Tax treaties

The United States has tax treaties with many countries to ensure no income is double-taxed by any country. When an individual earns income in multiple countries, there are specific provisions as to which country has primary taxing rights over such income. In these cases, the country that does not have primary taxing rights will instead allow a tax credit for foreign tax paid to the other country in order to alleviate the same income being taxed by both jurisdictions.

Tax treaties can also be utilized and analysed to determine residency status of an individual. There are certain provisions and criteria within each treaty that give guidance as to where an individual would be considered tax resident when he or she meets tax residency tests for two or more countries.

It is important to note that many states do not follow the same tax treatment with respect to treaty utilization and foreign tax credits. Therefore, in some instances, an individual may be considered a Non Resident for federal tax purposes, but a resident for state tax purposes. Or may be able to utilize foreign tax credits on their federal tax return, but not on their state tax return. These inconsistencies create complexities for determining US taxable income, therefore special attention must be paid to these circumstances.

Foreign Financial Reporting

There is a multitude of foreign financial informational reporting that must be disclosed to the IRS in connection with U.S. Tax Filings.

Form 8939 Statement of Foreign Financial Assets also is a reporting form that is included with an individual's income tax return if the individual held foreign assets above a set threshold. This reporting encompasses not only foreign bank accounts, but foreign assets that are owned including, but not limited to foreign interests in partnerships, stock, investment accounts, and pensions.

Additional disclosure is required with respect to stock holding of foreign corporations, partnerships, and trusts based on specific reporting criteria. The tax implications related to this reporting varies, however the fines associated with not reporting are penal so careful attention must be paid to the filing requirements.

The FinCEN 114 Report of Foreign Bank Accounts is a specific disclosure form filed with the U.S. Treasury Department that details all foreign bank accounts of an individual if at any time their aggregate bank account balance was above a certain threshold.

CHAPTER 8
Labor Regulations, Welfare, and Social Security

Employment and labor standards

Wages

The Fair Labor Standards Act (FLSA) establishes a minimum wage, overtime pay, record-keeping and child labor standards which affect full- and part-time workers in the private sector and in federal, state, and local governments.

FLSA requires that covered employees, unless otherwise exempt, be paid not less than one-and-one-half times their regular rates of pay for all hours worked in excess of 40 in a working week.

Workers generally must be paid no less than the statutory minimum wage as specified by either the federal, state, or local government. The federal government mandates a nationwide minimum wage level of $7.25 per hour.

State laws also apply to employment subject to the FLSA. When both FLSA and a state law apply, the law setting the higher standards must be observed.

Employee Benefits

- Unemployment compensation
  - Workers who lose their jobs often are eligible for benefits under a program financed by separate federal and state payroll taxes. To be eligible for benefits, employees must lose their jobs through no fault of their own and must have worked a minimum number of weeks or earned a minimum amount of wages.
  - Weekly unemployment benefits are usually a percentage of lost wages and are paid for a 26-week period. As a result of the American Recovery and Reinvestment Act of 2009, up to 99 weeks of benefits paid by the federal government in states with high unemployment rates are possible under certain conditions.
  - The so called FUTA tax rate (Federal Unemployment Tax Act) is collected by the IRS as an annual federal employer tax used to fund state workforce agencies and to cover the costs of administering the unemployment insurance and the job service programs.
  - The FUTA tax rate is 6 percent employees' taxable wages. Employers who pay the state unemployment tax on time receive an offset credit of up to 5.4 percent. Therefore, the net FUTA tax rate is generally .6 percent.
  - Within the above constraints, the individual states and territories raise their own contributions and run their own programs. The federal government sets guidelines for coverage and eligibility, but states may vary in how they determine benefits and eligibility.
- Unemployment insurance
  - Unemployment insurance (UI) programs provide unemployment benefits to eligible workers who become unemployed through no fault of their own and meet eligibility requirements determined on a state-by-state basis.
  - Eligible workers receive benefits from various programs within the UI umbrella, including federal-state UI, disaster unemployment assistance, federal employee unemployment compensation (UC), ex-service member UC, or trade readjustment allowances.
- Social Security
  - Social Security benefits are paid to a worker or the worker's family upon his or her retirement, disability, or death if the worker has insured status under the Social Security Act. The benefits are funded by taxes levied on employers, employees, and the self-employed.

  - The retirement age increases progressively from age 65 to 67, based on year of birth. A reduced benefit will be paid to an individual who retires before the designated retirement age. Benefits also are available to dependents of retired or disabled workers based on a certain percentage of the worker's benefit; this includes mainly spouses and surviving children. No citizenship or residency requirements are generally imposed for an individual to receive Social Security retirement, survivor, or dependency benefits. Benefits paid to an alien as a dependent or survivor of a covered employee will be suspended when the alien has been outside the United States for six consecutive months, except where the relationship upon which the benefit is based lasted at least five years.
  - The Social Security tax is imposed on employers and employees under the Federal Insurance Contributions Act (FICA) and is imposed on self-employed individuals under the Self-Employment Contribution Act (SECA). The FICA tax rate is 6.2 percent for employees and employers and is based on wages with respect to employment, generally including all remuneration for employment. Remuneration in excess of an annually adjusted cap of $118,500 for 2015 and are excluded from the definition of FICA wages. The employer is required to collect the employee's portion of the tax by means of a payroll deduction and to transfer this amount, along with the employer's portion of the tax, to the IRS.
  - The self-employment tax is imposed on the income of self-employed individuals if such earnings exceed $400 for the taxable year. Earnings subject to the tax are limited by the same annual earnings ceiling that limits the FICA tax. The self-employment tax is not imposed on non-resident aliens. This tax is paid as an addition to the income tax. Net earnings from self-employment include gross income derived from a trade or business, less trade or business expenses (excluding the net operating loss deduction), plus the individual's distributive share of income or loss from a business carried on as a partnership. Certain items are specifically excluded from self-employment income: interest, dividends, capital gains, and rentals from real property and personal property leased unless they are received by the individual in the course of his or her business as a real estate dealer. The general rate of self-employment tax for the 2015 tax year is 15.3 percent up to the federal FICA cap amount ($118,500).

- Health
  - The United State has enacted the Affordable Care Act (ACA), which requires all individuals be covered by health insurance through their employer. Certain small employers and qualifying individuals are allowed tax credits for some or all of the premiums paid. Employers with more than 50 employees will be required to provide full-time employees with health benefits. If employers or individuals chose not to purchase insurance, they are subject to penalties.
  - Medicare is a national social insurance program that provides health insurance for Americans aged 65 and older who have worked and paid into the system. Medicare benefits include hospital, medical, and drug insurance. The federal government pays 80 percent of the cost of covered services (including doctors' services, diagnostic tests, and other medical services). An annual deductible fee is imposed on patients, and patients generally pay the remaining 20 percent of the cost of the services. A monthly premium also is charged for medical insurance.
  - Medicare is funded by a 1.45 percent payroll tax imposed at the same rate on both the employer and the employee. Medicare does not have a cap and applies to almost all wages. The employer collects Medicare in the same way that FICA is collected and paid. A self-employed individual must pay the entire 2.9 percent tax on self-employed net earnings, but may deduct half of the tax from the income in calculating income tax. The tax rate will increase by 0.9 percent to 3.8 percent starting for employees with income above $200,000 ($250,000 for married couples filing jointly).

CHAPTER 9
Indirect Taxes

Even if there is no value-added tax on a federal level, several states impose sales or use taxes in addition to income and other real and personal property taxes.

Sales and use taxes

There is no federal sales tax or value-added tax in the United States. However, most states and many municipalities levy sales taxes. Combined rates, including local rates, can range as high as 12 percent.

Each state establishes the specific rate, as well as procedures to be used for registration, collection, and payment of the taxes due. Sales taxes are usually assessed on the final consumer purchase, with wholesale transactions remaining tax-exempt. Generally, all sales of tangible personal property occurring within a certain state are subject to sales tax unless specifically exempted by statute. The sales taxation of services and intangible property varies from state to state. It is the seller's responsibility to collect and remit sales tax. Usually the cost is passed to the consumer.

The obligation for an entity to collect sales tax is typically contingent on its physical presence in a particular state. If the entity does not have nexus in a state, it typically will not have to collect and remit sales tax to that state. Conversely, if an entity has nexus and is doing business in a particular state, upon delivery of a product to the final user within the state, sales tax must be collected from the buyer, and the required tax returns and tax payment must be remitted to the state or municipal taxing authority. This can be quite cumbersome if the company is doing business in many states.

Use taxes are a tax on the use, storage, or consumption of tangible personal property by a business itself within a state's borders. Use taxes are effectively a complement to sales tax. Generally, non-exempted tangible personal property purchased outside of the buyer's home state (e.g., the one in which it is doing business) and brought back into it, on which the out-of-state seller has not collected sales tax at least equal to the home state's use tax, is subject to the home state use tax. Out-of-state purchases of tangible personal property intended for resale by the buyer are exempt from home state use tax, but it will apply if it is for the buyer's use or consumption.

Other taxes

Taxes assessed on real and personal property are characterized as "ad valorem" taxes. They are assessed on the value of the property on a prescribed assessment date each year.

State and local governments may impose a number of other taxes, including taxes on special commodities (alcohol, tobacco, and motor fuel), fees for business and professional licenses, and taxes on special types of businesses, such as banking or insurance.

Property taxes

Property tax is an ad valorem tax on the value of property, assessed usually at the local jurisdiction level. Property tax can be assessed on real or tangible personal property.

Real property is often taxed based on its class, with classification grouping properties based on similar use. Properties in different classes are taxed at different rates. Examples of property classes are residential, commercial, industrial, and vacant real property.

County assessors, or state assessors for state-assessed property, determine the taxable value of property as of a specific period each year. The taxable value of real property is usually limited to its fair market value at the time of acquisition, plus an adjustment for inflation.

The rates of tax on each type of real or tangible business property vary greatly among jurisdictions.

Local taxes

Cities impose local-level sales and use taxes. Administratively, the sales taxes usually are collected by and remitted to the state, and then allocated to the localities. Generally, the rules for the localities are modeled after the rules for the states, but this is not always the case. Overall, there are thousands of indirect taxing jurisdictions in the United States. Any non-U.S. company doing business in the United States should be aware of all the various indirect taxes that may be imposed in the specific locality they are operating.

Import and export controls

Please see Chapter 2 for information on tariffs and fees related to imports and exports.

Other taxes

Depending on the nature of the business, its customers, and where it sells (including online), there could be many other tax implications. Companies coming to the United States should consult a CPA who specializes in U.S. and international taxation to best understand the regulatory environment and potential tax impact of doing business in the U.S.

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Team Members

Worldwide Desk:

- Jen Leary
- Jeff Kvilhaug
- Matthew Barnette
- Larry Chastang
- Dave Springstein
- Manesh Makwana

European Desk:

- Kevin Brown
- Amy Moore
- Aubrey Medal
- Lindsay Ennis

South/Central America Desk:

- Larry Chastang
- Frank Morera

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