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**DOING  
BUSINESS  
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**2006**

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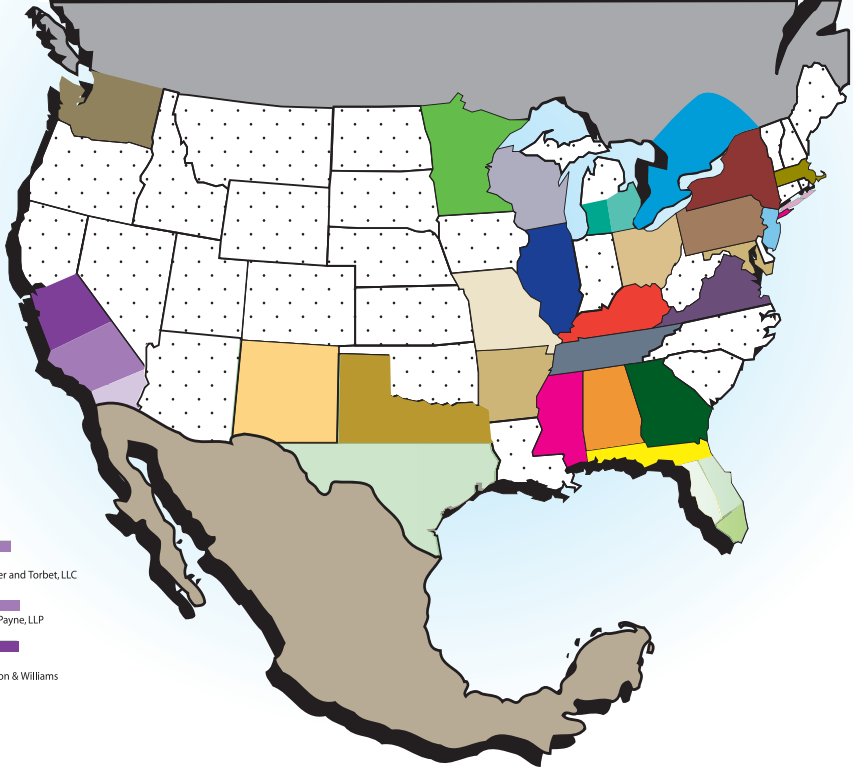
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## Introduction

This booklet is designed as a guide for doing business in the United States (U.S.). In addition to background information on the U.S., it includes relevant information on business operations and taxation matters. This guide will assist organizations that are considering establishing a business in the U.S., either as a separate entity or as a subsidiary of an existing foreign company. It will also be helpful to anyone who is planning to work or live permanently in the U.S.

The U.S. has a number of external territories, which include Puerto Rico, Guam, the U.S. Virgin Islands, and American Samoa. These external territories have their own legal systems and tax codes, neither of which is covered in this guide.

Unless otherwise noted, this information is believed to be accurate as of January 1, 2006. Special rules govern tax advice in the U.S., particularly when a taxpayer seeks protection for relying on advice from professionals. We are required by Circular 230 to advise you that general communications such as this booklet cannot be used, and are not intended to be used, for the purpose of avoiding penalties under United States federal tax laws.

This guide is distributed by Moore Stephens North America (MSNA), a leading international accounting and consulting network of 330 independent firms with more than 500 offices in over 90 countries. Moore Stephens was founded in 1907. Since that time, the Moore Stephens international network has grown to be the tenth largest international accounting and consulting group worldwide, with more than 15,000 principals and staff members. Further information may be obtained at MSIL's website: [www.moorestephens.com](http://www.moorestephens.com)

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## How to Use This Guide

This guide provides an overview of relevant U.S. information for your business or personal needs. It is essential that advice be obtained from local professional sources, such as CPAs and lawyers, before any business is undertaken.

It should also be noted that background information on the U.S. is available through U.S. government data. Details are available on the Internet, so we have provided the reader with a resource tool in Appendix A that contains a list and brief description of some of the most valuable and informative websites.

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# 1. The United States of America – A General Overview

## Population

The United States of America comprises 48 contiguous states and two noncontiguous states, Alaska and Hawaii. Washington is the nation's capital, located in the District of Columbia (D.C.) between the states of Maryland and Virginia.

Additionally, the U.S. includes several holdings—the Commonwealth of Puerto Rico, the Virgin Islands of the U.S. in the Caribbean Sea, and the islands of American Samoa and Guam in the Pacific Ocean.

Based on the U.S. Census of 2002, the population in 2002 was approximately 282,000,000, making it the third most populous country, after China and India. This represents a 13.2 percent increase since 1990.

More than 11 percent -- over 31 million -- of the population is foreign born.

The ten largest metropolitan areas, ranked by population per the 2000 U.S. Census, are:

1. New York City, New York
2. Los Angeles, California
3. Chicago, Illinois
4. Washington D.C./Baltimore, Maryland
5. San Francisco/Oakland, California
6. Philadelphia, Pennsylvania
7. Boston, Massachusetts
8. Detroit, Michigan
9. Dallas, Texas
10. Houston, Texas

America is both vast and dense. The continental United States, which excludes Alaska and Hawaii, is about the size of Australia. At the same time, the population of the New York City metropolitan area — also referred to as the tri-state area (50 miles radiating from the Empire State Building) is about equal to Australia's 20 million people.

English is the predominant language although, as of 2000, about 4.3 percent of the population spoke little or no English.

## **Geography and Climate**

The land mass is 9.6 million square kilometers, or 3.7 million square miles, and is third in size after Russia and Canada. The contiguous 48 states are bound on the west by the Pacific Ocean; on the north by Canada; on the east by the Atlantic Ocean; and on the south by Mexico and the Gulf of Mexico.

The climate is as diverse as the topography. Regions of the country, which include Hawaii and parts of Florida are tropical. It is humid in the East and Southeast and arid in the West.

## **Government**

The U.S. Constitution defines a federal system of government in which certain powers are delegated to the national government and others are reserved to the states. The national government consists of the executive, judicial and legislative branches. They are designed, through separation of powers and a system of checks and balances, to ensure that no branch of government is subordinate to the other two. All three branches are interrelated; each with overlapping, yet quite distinct, authority.

The federal government includes a number of independent administrative agencies that have been created by the legislative branch or by executive order. These agencies include the Internal Revenue Service, the U.S. Securities and Exchange Commission, and the U.S. Customs Service. The U.S. Customs Service is now part of the U.S. Department of Homeland Security. These agencies have generally been given the power to create and enforce rules and impose penalties for not following them.

The state governments have structures that closely parallel the structure of the federal government. Each state has a governor, a legislature, and a judiciary. The state government is usually housed in each state's capital city. Each state (and most cities, counties and towns) has its own system to provide for local government services. States are subdivided into counties, cities and towns; and each subdivision generally has its own form of local government.

## Religion

The varieties of religious beliefs in the U.S. surpass the multitude of ethnicities, nationalities and races. The vast majority of Americans (83 percent) identify themselves as Christian. One-third of this group is not affiliated with any church. The remaining number belongs to a wide variety of churches that differ on theology, organization, policies and programs. The largest number is Protestant, under which are hundreds of separate denominations. Roman Catholics constitute the next largest group, followed by the Eastern Orthodox Church. Judaism is the next largest religion in the U.S., which comprises about two percent of the population. Some eight percent of the population is either nonreligious, secular, or are atheists.

## Education

American public education is primarily the responsibility of the states and individual school districts, unlike the nationally regulated and financed education systems of many other industrialized societies. In 1999, states contributed 49 percent of the elementary and secondary school revenues, and local school districts contributed 44 percent. The Federal government provided 7 percent.

The public school system serves many. In 2002, the last year for which data is available, 86 percent of Americans between ages 25-29 had graduated from high school, 58 percent had completed some college, and 29 percent had earned at least a bachelor's degree.

While the clear majority of Americans attend public schools, a 1994 study showed that 11 percent attended private elementary and private high schools. The majority of these private schools were Catholic schools.

Post-secondary education is not dominated by public institutions, but by a mix of public and private institutions, many of which have church and religious origins.

## **Communications and information technology**

Personal and mass communications are pervasive in American culture. There are 194 million main line telephones in the U.S. (1997) and 69 million cellular telephones (1998). Americans own 219 million televisions (1997) and 575 million radios (1997).

As of 2002, there were more than 165 million Internet users. According to Digital Economy 2003, a report from the National Telecommunications and Information Administration, the growth of Internet users in the U.S. is currently 2 million new users per month. Greater than three-quarters of U.S. households have online access.

According to this same report, there are significant economic implications of Internet popularity in the culture as many transactions are now conducted online (e-commerce) and firms are improving business processes through increased use of information technology (IT).

## **Times, weights and measures**

There are four major time zones in the continental U.S.: Pacific, Mountain, Central, and Eastern. Most areas of the U.S., other than Arizona and parts of Indiana, observe daylight savings time. There are two additional time zones in Alaska and one additional time zone in Hawaii.

The U.S. customary system of units is used for weights and measures, although many consumer goods must be labeled using the metric system as well. The U.S. Congress has enacted legislation that requires an eventual transition to the metric system.

## **Currency**

The U.S. dollar (\$) is the unit of currency. The smallest unit of currency is the penny or cent (¢). The dollar is equal to one hundred cents. The Federal Reserve System is the central banking system that manages the currency.

## Inflation

The inflation rate for 2005 was 3.4 percent. Recent yearly percentage rates:

<b>2004</b>	<b>2.2%</b>
<b>2003</b>	<b>2.3%</b>
<b>2002</b>	<b>1.6%</b>
<b>2001</b>	<b>2.8%</b>
<b>2000</b>	<b>3.4%</b>
<b>1999</b>	<b>2.2%</b>

Please refer to the resource tool in Appendix A of the guide for a list of websites, one or more of which contain updated information.

## Gross domestic product

In figures released by the U.S. Bureau of Economic Analysis, the gross domestic product (GDP) the output of goods and services produced by labor and property located in the U.S. increased by 4.5 percent in the first quarter of 2004, and 2.8 percent in the second quarter of 2004. These figures are the most recent figures available. In 2003, quarterly GDP increases were: fourth quarter, 4.1 percent; 3rd quarter, 8.2 percent; second quarter, 3.1 percent; and first quarter, 2.0 percent. This compares with an increase of 2.2 percent overall for the year 2002, 0.5 percent for 2001, and 3.7 percent for 2000. Please refer to the resource tool in Appendix A of the guide for a list of websites, one or more of which contain updated information.

## 2. Forms of Business Organization

Business can be conducted in the U.S. through:

- Unincorporated branches of foreign entities
- Corporations
- Limited liability companies (LLCs)
- General partnerships, limited partnerships & joint ventures
- Trusts
- Sole proprietorships

Investors are free to choose their preferred form of entity. Non-U.S. entities are viewed as one of the following: corporations, branches/proprietorships, or partnership-like entities for U.S. tax purposes under guidelines similar to those governing U.S. entities. However, some entities can elect to be treated as either a partnership or a corporation for U.S. tax purposes if the “default” characterization is undesirable.

Business entities, regardless of their statutory form, are treated for tax purposes as corporations, trusts, partnerships or disregarded tax entities. Disregarded tax entities are 100% owned entities that take on the tax characteristics of their owner (i.e., they are considered a branch if the owner is a corporation or other business entity, or they are considered a sole proprietorship if the owner is an individual).

A corporation is a distinct legal entity created under state law. Delaware has historically been the most popular state in which to incorporate. However, most states have modified their corporate laws to mirror those of Delaware. Depending upon where the corporation will do business, Delaware may no longer be the best choice.

The limited liability company is a recently invented hybrid entity that provides corporate-style liability protection and partnership-style “flow through” tax treatment. “Flow through” means that, generally, the owners pay tax on their shares of the entity’s income, rather than the entity paying the tax. In addition, limited liability companies can elect to be treated as partnerships or corporations for U.S. tax purposes. This option is not available to U.S. corporations. The members of a limited liability company have limited liability similar to corporate shareholders. Members may participate in the management of the company pursuant to the membership agreement.

In a general partnership, including joint ventures, all partners have unlimited liability. General partners may participate in the management of the partnership. A limited partnership requires at least one general partner, which has unlimited liability. The limited partners are only liable up to their capital contribution, but they may not participate in the management of the partnership.

Trusts include the estate of a decedent, and specialized entities not widely used but that have aspects similar to that of partnerships.

### **Costs of creating an entity**

The costs of creating an entity vary widely by state and the entity chosen. Additional costs may be incurred in obtaining professional advice as to the proper structure, type of entity to be used, etc.

### **Branch Operations**

It is relatively easy to establish a branch operation in the U.S. Generally, the foreign entity must register with the state(s) and city(ies) where the branch will operate, and obtain a license to do business in the state(s).

## **Representative Offices**

Representative offices of a foreign entity may be established for planned activities limited to those activities that are allowed under an applicable U.S. income tax treaty. Generally, to avoid subjecting the foreign entity to U.S. income tax, such activities must not include any kind of activities that would be attributed to the foreign entity under the specific treaty. If a foreign entity would be subject to U.S. taxation absent an applicable U.S. income tax treaty, the entity generally must still file a U.S. income tax return. The U.S. tax return required in this case acts as a disclosure document, informing the U.S. Internal Revenue Service that the entity is relying on the applicable treaty to avoid U.S. taxation.

## **Registrations**

Once formed, every business entity must obtain a unique U.S. federal employer identification number (“EIN”). This number identifies the taxpayer/entity and is required regardless of whether the entity expects to have employees. Most states require notification, and some states assign special state numbers.

If a business employs or expects to employ workers, it must obtain several additional registrations and certain insurances for the benefit of its workers. The requirements vary for each state and, sometimes, the requirements vary for local jurisdictions.

A separate state registration is often required for sales and use tax.

## **Shelf companies**

The concept of acquiring shelf companies is not practiced in the U.S.

## **3. Entity Formation and Statutory Requirements**

### ***Corporations***

#### **Share Capital**

The amount of required minimum share capital varies by state. Such minimums are generally not substantial in amount. Capital contributions can be made in the form of cash, property, or in-kind services. The initial shares do not need to be fully paid up before registration. A U.S. corporation may be owned 100 percent by foreign persons or companies.

#### **Memorandum and Articles of Association**

A foreign investor who intends to set up a subsidiary in the U.S. must form a new company or purchase the shares in an existing company already operating in the U.S.

#### **Procedure for Formation**

An incorporator, who files Articles of Incorporation with the applicable state authorities, generally forms the company. The incorporation is then ratified by the shareholders, and the directors are elected by the shareholders. Once a corporation is formed, it has the right to do business in its state of incorporation. A separate registration to do business as a “foreign” corporation should be filed in any other state in which the corporation does business. Note that “foreign” in this context means any other state of the U.S., not a foreign country.

Note that many states take the position that U.S. income tax treaties are not applicable to state taxes. Thus a foreign entity not subject to U.S. taxation under an income tax treaty may still be subject to state and local taxes in the U.S.

## **Information on Public Record**

The state in which the corporation is organized determines what information must be filed on public record with the state. The information may include:

- The share capital
- Names and addresses of the board of directors and the managing director(s)
- Names and addresses of shareholders with voting powers of five percent or more
- The articles of association

Financial statements for privately-held entities are generally not considered public information.

## **Limited Liability Companies**

Limited liability companies (LLCs) are considered the most flexible type of entity for use in achieving both business and tax objectives. LLCs provide the members with limited liability, similar to a corporation, but the LLC's profits are taxed only once at the member level. A corporation's profits are taxed twice—once at the corporate level and again at the shareholder's level when the profits are distributed.

## **Capital**

The amount of minimum capital required by a member varies by state. Such minimums are generally not substantial in amount. Capital contributions can be made in the form of cash, property, or in-kind services. A U.S. LLC may be owned 100 percent by foreign persons or companies.

## **Procedure for Formation**

An LLC generally must file its articles of organization with the state or local jurisdiction (e.g., county or city) in which it is located or intends to do business.

## **Liabilities of Members**

The liability of each member of an LLC is generally limited to the member's capital contribution. One frequent exception however, relates to the so called "trust fund" taxes withheld from employees or collected as sales tax from customers. People responsible for these funds, and in some cases, all owners can be personally responsible when these amounts are not properly paid over to the governments for whom they are collected.

## **Information on Public Record**

The state in which the LLC is organized determines what information must be filed on public record with the state. The information may include:

- The amount of each member's initial contribution to capital
- Names and addresses of each member
- The rights of each member to the LLC's profits

## ***Partnerships***

### **Capital**

The amount of minimum capital required by a partner varies by state. Such minimums are generally not substantial in amount. Capital contributions can be made in the form of cash, property, or in-kind services. A U.S. partnership may be owned 100 percent by foreign persons or companies.

### **Procedure for Formation**

A partnership can be created without a written document, although a written agreement is always highly recommended. A partnership is generally required to register with all states or local jurisdictions (e.g., county or city) in which it intends to do business.

### **Liabilities of Partners**

Each partner in a general partnership is jointly liable for all debts and obligations of the partnership. To limit the partners' liabilities, the parties may instead want to consider using a limited liability company, a limited liability partnership or a limited partnership. Although taxed differently, a corporation can also be used to limit liability.

## **Information on Public Record**

The state in which the partnership is organized determines what information must be filed on public record with the state. The information may include the:

- Amount of each partner's initial contribution to capital
- Names and addresses of each partner
- Designation of each partner as either a general or limited partner
- Rights of each partner to the partnership's profits

## **4. Audit and Accounting**

### **Financial Statements**

The operators of each business are generally responsible for the maintenance of reasonable accounting records and for the preparation of annual accounts covering each accounting period. In a corporation, the officers are responsible. The officers are elected by the directors. In the case of a small privately held business, the owners, officers, and directors are often the same individuals. In the case of a partnership or LLC, the managing partner or managing member is generally the responsible party.

The annual accounts must be approved by the owners (shareholders, partners or members), usually at the annual general meeting.

The trustee of a trust has similar statutory responsibilities to keep books and records. A sole proprietor has similar responsibilities under the tax law.

### **Accounting period**

As a general rule, corporations may adopt a tax year ending on the last day of any calendar month. Partnerships and LLCs must generally adopt a tax year that is the same as the year-end of a majority of the partners or members.

### **Audit**

Generally, only publicly traded companies must be audited by an independent auditor who is a certified public accountant (CPA). Public companies and their auditors are subject to special rules that were enacted in 2002 by the Sarbanes-Oxley Act (SOX). This act created the Public Company Accounting Oversight Board (PCAOB) and a separate set of audit standards, rules, and governance systems to regulate public companies and their auditors. The PCAOB reports to the Securities and Exchange Commission (SEC). The form and content of public company reports is, accordingly, different from private company reporting; and all CPA's must register with the PCAOB to conduct audits of these entities.

Private companies are audited by CPAs under standards established by the American Institute of Certified Public Accountants (AICPA). While not required by regulation, many private companies want or need audits to provide their owners, managers, lenders, and customers the highest level of assurance about the financial statements of the organization.

Other private businesses often elect to forgo an audit but to have their financial statements subjected to a lesser standard of third-party assurance provided by CPAs, such as a review or a compilation. There is no requirement for a privately-held business to produce a full set of traditional financial statements to file an income tax return, although an income tax return will include most of the information found in an income statement and balance sheet but do not contain footnotes.

## 5. Labor Relations and Working Conditions

The responsibility of the U.S. Department of Labor (DOL), administered by a Secretary appointed by the President, is to foster, promote and develop the welfare of wage earners of the U.S.; to improve their working conditions; and to advance their opportunities for profitable employment.

Regulation by the DOL offers protection with regard to work hours, minimum wages, benefits and non-discrimination. Private industry is permitted to set individual work conditions within regulations. Federal and state labor relations laws guarantee to workers the right of free association in unions, although since the mid-1980s, the power of organized labor has decreased considerably. More and more people have become employed in service organizations rather than in manufacturing, which has reduced union membership. This process has been heightened by other economic and political factors.

### Employee benefits

A survey conducted in 2000 by the DOL's Bureau of Labor Statistics provides a helpful snapshot of today's benefits picture in private industry; for example, paid vacations were available to 80 percent of employees in private industry and paid holidays were available to 77 percent. More than one-half (52 percent) of employees participated in medical care plans and 48 percent were covered by retirement benefits of either a defined benefit plan (19 percent) or a defined contribution plan (36 percent). Seven percent of employees participated in both types. Life insurance was available to more than one-half of all employees in private industry. Short-term disability insurance and long-term disability insurance were available to 34 percent and 26 percent of employees, respectively.

The following are typical paid holidays: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, and Christmas Day. Many employers offer personal days for birthdays or floating holidays that vary each year.

Paid vacations vary and are usually based on an employee's length of service. Additional benefits being offered in the modern American workplace today include educational assistance benefits, subsidized commuting, child care, adoption assistance, long-term care insurance, wellness programs, and flexible workplace (allowing employees to work flexible hours and/or from home).

## 6. Income Taxation

There are two basic U.S. income tax regimes for business entities: the corporate regime and the partnership “flow through” regime.

Under the partnership flow-through regime, the business entity is not subject to direct income taxation. Instead, the entity’s profits “flow through” to its owners and are taxed in most ways as if earned directly by the owners. Partnerships and most limited liability companies are treated as flow-through entities for U.S. tax purposes. However, as previously noted, partnerships and limited liability companies can elect to be taxed as corporations for federal (and usually state and local) tax purposes. Nearly all owners, including foreign owners, of a flow-through entity must file a U.S. income tax return. The exceptions are certain, relatively rare, types of investment partnerships.

The corporate tax regime is often preferable for foreign owners because it isolates U.S. operations, and most foreign owners can use tax credits for taxes paid by a U.S. corporation when dividends are remitted home. Owners of entities taxed as corporations do not have to file U.S. tax returns, although direct owners have to identify themselves to receive dividends. The flow-through regime is generally more advantageous for U.S. non-corporate owners, because income is only taxed once, at the ownership level, rather than twice, once when earned by the corporation, and again when distributed to the U.S. owner. Of course, each investor’s tax strategy must be tailored to his or her individual circumstances, and dozens of other factors may apply in each particular investment situation.

Trusts, certain electing domestically-owned corporations called “S” corporations, and other special flow-through tax regimes exist. Some are industry specific. Because of their limited applicability, these regimes are not discussed in this guide.

Please contact a Moore Stephens North America professional for further information.

## 7. Corporate and Business Taxes (Income and Franchise)

### U.S. Federal Tax Rate

For 2005 taxable income—including capital gains—is subject to a federal corporate income tax at graduated rates, as follows:

<b>Taxable Income Over</b>	<b>But Not Over:</b>	<b>The Tax is:</b>	<b>Of the Amount Over:</b>
Nil	\$50,000	15%	Nil
\$50,000	75,000	\$7,500 + 25%	\$50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	--	35%	0

A corporation organized in the U.S. is subject to federal corporate income tax on its world-wide income. The foreign tax credit, subject to various limitations, is designed to minimize the effects of any “double” taxation by the U.S. and a foreign jurisdiction.

Groups of corporations with greater than 80% common ownership are only entitled to benefit from the lower tax brackets above (i.e., 15%, 25%, 34%) only once per year, and thus must share the use of such lower brackets among the members of the group (generally in any manner that they formally elect).

The federal tax rate is identical for corporations and branches. An alternative minimum tax of 20 percent applies if a substantial amount of a corporation’s deductions are “preference items,” such as accelerated depreciation and certain other front-loaded deductions.

Note that various tax incentives are available under U.S. laws that have the effect of reducing the federal income tax rate. Many of these incentives are available only for specific industries (such as oil and gas extraction) while others are broadly available. For instance, a tax credit is available for (qualifying) expenditures made in research and development and—perhaps most important—companies that manufacture in the United States may qualify for the domestic manufacturing deduction.

A domestic or foreign corporation that owns a U.S. branch or all or a part of a flow-through entity files and pays corporate income taxes. In most cases, a withholding or “branch profit” tax is also due when earnings are returned or deemed returned to a foreign parent company. An individual owner of a U.S. branch or flow-through entity files and pays individual income tax (see section 11).

## **Withholding by Flow-Through Entities**

If the U.S. entity is a partnership or LLC that does not elect to be taxed as a corporation, each partner or member is subject to U.S. income taxation on its share of the entity’s profits. In some instances, the partnership or LLC is required to withhold and remit U.S. and state income taxes on a quarterly basis. These “withholdings” are based on profits allocated to foreign partners, **not** actual cash or property distributions; accordingly, they are generally greater than the actual tax due. A refund can normally be obtained by filing a tax return

## **Filing of Tax Returns**

Corporate tax returns must be filed annually. The federal tax return is due on the fifteenth day of the third month after the end of the tax year (i.e., March 15 for calendar year corporations). If the due date falls on a Sunday or federal holiday, the due date becomes the next business day.

Although partnerships and LLCs are generally not directly subject to U.S. taxation, they must file informational federal tax returns that are due on the fifteenth day of the fourth month after the end of the tax year. Since these entities are “flow-through” entities, their owners are obligated to pay tax on their proportionate share of the entity’s income. Owners must file and pay taxes based on their fiscal year and organization type (i.e. individual, corporation, etc). While foreign owners are often subjected to a “withholding tax” on their share of earnings as discussed above, this is a tax deposit, not a payment of

tax, which can only be done by filing a tax return. A corporation or partnership (including most domestic LLCs which are treated as partnerships) may request an automatic six-month extension to file its tax return. Payment of any corporate tax due with the return is required to be paid at the time of the original due date of the return prior to extension. Underpayments result in the imposition of interest and possible penalties from the original unextended due date to the actual date of filing and payment. The federal tax return of a foreign corporation with no office or fixed place of business in the U.S. is due on the fifteenth day of the sixth month after the end of the tax year. An automatic six-month extension can be requested.

State and local income tax return due dates generally follow federal due dates, although in some cases, they lag the federal dates by one month. Some states allow partnerships and LLCs to file a single “composite” income tax return on behalf of all the owners.

## **Payment and Collection**

Corporate income tax is generally paid during the fiscal year when income is earned. Interest and penalties are generally charged on any underpaid or unpaid installments. The state and city income/franchise payment rules are generally similar to the federal rules.

Partnerships and LLCs are required to withhold and remit taxes on behalf of their partners and members in certain special situations. Often, they are required to remit tax based on the entity’s earnings, not on actual distributions. The special situations include earnings attributable to foreign partners or foreign members for U.S. federal tax purposes and earnings attributable to partners or members not resident in the entity’s state for state income tax purposes. These rules, especially at the state level, are relatively new and are evolving quickly. Thus, they must be actively monitored.

Foreign partners in a U.S. partnership and foreign members of a U.S. LLC are generally required to file federal and state income tax returns and report their share of the entity’s profit or loss. The taxes withheld as described above are credited against the liability computed, and the partner or member pays any additional taxes due or receives a refund of any overpayment.

## **State and Local Income Taxes**

Almost all states (and some cities and counties) impose a corporate income or franchise tax in addition to the federal income tax.

State rates vary and can be as high as 12 percent. Although each state computes taxable income differently, most of them begin with federal taxable income. Many states also tax capital, either as a separate tax or through an alternative tax base in which the business pays the higher of the income tax or the capital tax. The most common state adjustments to federal taxable income involve depreciation, loss carryforwards, and the treatment of related-party transactions. Income is generally apportioned to the states within which the corporation operates under a three-factor formula based on a percentage of sales, payrolls, and property attributed to each state.

Also, some cities impose corporate income and/or franchise taxes (e.g., New York, Philadelphia and several cities in Michigan and Ohio), after incorporating the state adjustments. Cities may also impose a personal property tax.

## **Grouping / Consolidated Returns**

Certain affiliated corporations may elect to file a single, consolidated federal income tax return for all members of the affiliated group. The consolidated tax return is a tax computation mechanism, and it does not convert the group into a single corporation. Each member of the group is severally liable for the entire tax of the consolidated group.

Generally, only U.S. corporations are permitted to be included in a consolidated tax return. Under very limited conditions, Mexican and Canadian corporations can be included in the filing of a consolidated return. An affiliated group consists of a common U.S. parent corporation and at least one other U.S. corporation in which the parent owns at least 80 percent of the total voting power and total value of the stock. Any other U.S. corporations that are connected to each other or to the parent under the same percentage of ownership tests are to be included in the consolidated return. Brother-sister corporations related through ownership by individuals are not permitted to file a consolidated return.

A foreign corporation that controls several U.S. subsidiaries, some of which generate profits and others that sustain losses, will often derive tax advantages by establishing a U.S. holding company to hold the stock of its U.S. subsidiaries. This allows the group of

U.S. companies to file a consolidated return to offset any operating losses of members against the taxable income of other members. If a consolidated return is not filed, a foreign corporation may find its profitable U.S. subsidiaries paying tax and its unprofitable U.S. subsidiaries deriving no current benefit for losses generated.

Most states tax each corporation separately. Some allow consolidated or combined returns to be filed. Many states require an affiliated group of corporations that operate as a “unitary business” to report income on a combined basis. Although mechanically different, this has the same effect as filing a consolidated return.

## **Corporate Residence and Territoriality**

A corporation is resident in the U.S. for tax purposes if it is incorporated in the U.S. A U.S. corporation is subject to corporate income tax on its world-wide profits including capital gains. A foreign tax credit mechanism, subject to various limitations, is available to alleviate the possibility of double taxation of income.

## **Permanent Establishment**

Non-resident companies conducting business in the U.S. through a permanent establishment (e.g., a branch) located in the U.S. are subject to income tax on all income attributable to or received from such a permanent establishment.

The branch profits tax generally applies to the branch’s earnings (after income tax) that are deemed repatriated to the home office. The tax rate is generally 30 percent, unless modified or eliminated under an applicable U.S. income tax treaty. In addition, a branch is required to withhold 30 percent of the interest actually and deemed paid by the branch to the home office or a non-U.S. lender. This withholding tax may also be modified or eliminated under a U.S. income tax treaty.

## **Investment in U.S. Real Property**

All non-residents (corporations, individuals, etc.) are subject to U.S. income tax on income from real property situated in the U.S., whether the real property is owned directly or through a business entity, including a corporation. Non-residents must file a U.S. tax return to declare such income when title to real property is transferred directly or through the sale of a U.S. business entity.

## **Withholding Tax**

Certain types of payments constituting U.S. source income made to non-residents are subject to U.S. withholding tax. The non-treaty withholding rate is 30 percent, which may be reduced under an applicable income tax treaty. Most new U.S. income tax treaties contain a “limitation on benefits” article, which is designed to limit treaty benefits to qualified residents of the two countries. A U.S. payer is required to obtain information for its files from the payee to support a treaty rate of withholding. In addition, the payer may be required to report the payments to the IRS. The withholdings must also be remitted to the IRS within a specified period of time (depending on the amount of the withholdings) or penalties and interest can be charged.

## **Dividends**

All dividends paid by a corporation to its non-U.S. shareholders are subject to a 30 percent withholding tax, unless modified or eliminated under a U.S. income tax treaty.

## **Royalties**

Withholding tax is applicable to all royalty payments for the use—or the right to use—patents, trademarks, designs or models, plans, secret formulas or processes; or information concerning industrial, commercial or scientific processes. Payments for the purchase of underlying intangible assets are generally not subject to withholding tax. However, payments for access to know-how may be deemed to be a license subject to withholding tax.

## **Interest**

Interest payments made to non-residents are generally subject to withholding tax. See the section titled “Thin Capitalization” later on.

## **Losses**

Generally, a tax loss must be carried back two years and then carried forward 20 years to offset other taxable income.

In corporate acquisitions, the use of the acquired company's tax loss carryforwards is generally restricted or forfeited.

## **Start-Up, Organizational Costs and Capital Costs**

A taxpayer may elect to deduct up to \$5,000 of start-up costs and \$5,000 of organizational expenditures in the taxable year in which the trade or business begins. However, each \$5,000 is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds \$50,000, respectively. Start-up and organizational expenditures that are not deductible in the year in which the trade or business begins are amortized over a 15-year period.

Costs associated with investigating a new business are considered start-up costs.

Costs associated with investigating a new business must be carefully analyzed since most of them are often considered start-up costs.

## **8. Payroll Taxes and Social Security**

### **Payroll Taxes**

Employers are subject to several types of employment taxes. In some cases, the employer is acting as the tax collector for the government. In other cases the employer is paying its own tax costs. Employers are required to deduct and withhold federal, state, and local income taxes from the salaries and wages of their employees. The Federal government also imposes Social Security taxes on both employees and employers (see below). There are also certain federal, state, and local taxes and related insurance costs that are assessed and collected as part of the payroll process. These include payments for worker's compensation (on-the-job injuries) and unemployment insurance, which is charged at both the federal and state level.

### **Social Security Tax**

The Social Security tax is imposed on employers and employees under the Federal Insurance Contributions Act (FICA). It is also imposed on self-employed individuals under the Self-Employment Contribution Act (SECA). The FICA tax is imposed at the same rate on both the employee and the employer. The employer is required to collect the employee's portion of the tax through a payroll deduction and then promptly remit the withholding along with the employer's portion of the tax to the government.

In 2006, employment income up to \$94,200 is taxed at 15.30 percent (7.65 percent is paid by the employer and 7.65 percent is paid by the employee). Employment income in excess of \$94,200 is taxed at 2.9 percent (1.45 percent is paid by the employer and 1.45 percent is paid by the employee). The \$94,200 base is indexed annually.

SECA is imposed on the self-employment income of self-employed individuals if their earnings equal or exceed \$400 for the taxable year. The same annual FICA earnings ceiling limits (see above) apply to earnings subject to SECA, although the self-employed individual is responsible for both the employer and employee portions. One-half of this amount is generally deductible in arriving at federal taxable income.

Note that some foreign countries have social security agreements with the U.S., which may reduce or eliminate the U.S. FICA tax and SECA tax (see next page).

## Totalization Agreements

The U.S. has entered into agreements, called *totalization* agreements with a number of nations for the purpose of avoiding double taxation of income with respect to social security taxes in a worker's earnings, and the need to coordinate benefits at a later date.

At the time of this writing, the U.S. currently has entered into international social security totalization agreements with Australia, Austria, Belgium, Canada, Chile, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, South Korea, Spain, Sweden, Switzerland, and the United Kingdom.

As of this printing, agreements are pending or under negotiation with the Czech Republic, Denmark and Mexico. For further and up-to-date information, refer to [www.ssa.gov/international](http://www.ssa.gov/international).

## 9. VAT / GST / Sales and Use Tax

The United States' equivalent to a VAT or GST tax is the Sales and Use Tax. Sales and use taxes are imposed at the state and local level. Forty-six states, the District of Columbia, and many local jurisdictions impose sales and use taxes.

Generally speaking, sales or use tax is imposed on the sale or purchase of tangible property and some services. Each state or local entity governs the property and services that are subject to sales or use tax within its jurisdiction.

A business can be held responsible to collect the sales or use tax on their sales to the extent that the business has "nexus" within the jurisdiction that imposes the tax. Sales tax nexus is created by a "physical presence," temporarily or permanently, within the jurisdiction. Some examples of activity that create this physical presence include an office, owning property, or traveling into a jurisdiction to solicit sales. It is much easier to create sales tax nexus than income tax nexus.

Once nexus is established, the business will need to determine if the product or service sold is subject to sales or use tax. The applicable state (and local in some instances) laws need to be examined for the sales tax implications. States typically exempt wholesale sales, or sales for resale. Many states have exemptions for government entities, educational institutions, and non-profit entities. Typically, customers provide the vendor with an exemption certificate to claim an exempt status. To the extent a sale is not exempt, sales or use tax should be charged.

If taxable property or services are purchased from a vendor and the vendor does not charge the corresponding sales tax, the purchaser is liable to pay the tax directly to the state or local jurisdiction. The use tax is a complementary tax to the sales tax and is intended to tax products or services when the vendor does not have nexus within the jurisdiction.

Several states joined together to create a Streamlined Sales and Use Tax Agreement. The purpose of the agreement is to simplify and modernize sales and use tax administration in the member states to substantially reduce the burden of tax compliance. The agreement is intended to encourage sellers without a physical presence in the state to voluntarily register and begin collecting tax in response to the simplifications and the extended amnesty. The member states hope that Congress will eventually grant them the authority to compel sellers to collect and remit tax on remote sales. Additional information on the Agreement may be found at <http://www.streamlinedsalestax.org>.

# 10. Special Interest Issues

## Transfer Pricing

The United States, like most developed countries, has established rules and regulations regarding the ability of the IRS to allocate gross income, deductions, and credits between “related” taxpayers to the extent necessary to prevent evasion of taxes or to clearly reflect the income of related taxpayers.

The U.S. regulations are based on the principle that transactions between related parties (controlled transactions) should be evaluated on an “arm’s-length basis.” In other words, the pricing between related parties is evaluated against data supporting how unrelated parties would structure a similar transaction. Without these provisions, taxpayers could engage in abusive transactions with affiliates to minimize or eliminate taxes in higher tax jurisdictions.

The transfer pricing regulations provide taxpayers with guidelines to follow and enumerate the permissible methods that can be used in supporting the transfer price. Failure to follow the transfer pricing guidelines can result in adjustments to taxable income and in some cases the imposition of substantial penalties. Transfer pricing documentation must be prepared **before** a tax return is filed to avoid the most severe penalties

## CFC Taxation

The U.S. has had a Controlled Foreign Corporation (CFC) anti-deferral tax regime since 1962. Under this regime, certain income earned by a CFC, referred to as “subpart F income,” is taxed currently to the U.S. shareholders of the CFC, rather than at the time of distribution of such earnings. Undistributed taxed earnings are deemed to be distributed and re-contributed to capital, so the shareholder’s basis is increased to the extent that income taxation is accelerated. Additionally, the character of gains on the sale of CFC shares is often partly considered dividend income and partly capital gain under these rules.

A foreign corporation is a CFC if five or fewer “United States shareholders” own more than 50 percent of the total combined voting power or value of the foreign corporation. A “United States shareholder” is a U.S. person (a U.S. citizen or resident individual, corporation, partnership, estate or trust) owning at least 10 percent of the voting power or value of the foreign corporation. The ownership rules are complex and often consider related entities and families as a single owner.

The most common types of subpart F income are as follows:

1. Passive income, such as interest, dividends, rents, royalties, and net gains from the sale of assets producing the passive income. Rents and royalties are excepted if they are generated from an active business. Interest and dividends are excepted if they are received from a related person located in the same country as the CFC.
2. Income from the sale of goods outside the CFC's country of incorporation, if the goods are sold to or purchased by a related party.
3. Income from the performance of services for a related party, outside the CFC's country of incorporation.
4. A CFC's earnings that are invested in U.S. assets.

Generally, the income is not considered subpart F income if either (1) the income is subject to a foreign tax rate of greater than 90 percent of the maximum U.S. tax rate; or (2) the CFC's subpart F income is less than the lesser of (a) five percent of the CFC's gross income; or (b) \$1,000,000.

All calculations related to the CFC's activities are made using U.S. tax accounting principles in U.S. dollars. For example, depreciation must be recalculated using U.S. rules, and only 50 percent of meals and entertainment expenses are deductible, as under U.S. tax law. Thus, in many cases, the income computed under U.S. tax principles is greater than the income computed under local (foreign) law.

Strict annual disclosure rules apply to all CFC's and may apply to any greater than 10 percent owner, director or officer in a foreign corporation.

## **Passive Foreign Investment Companies**

The passive foreign investment company (PFIC) rules apply to any U.S. shareholder of a PFIC, regardless of the total U.S. ownership percentage.

A PFIC is any foreign corporation that meets either an income test or an asset test. Under the income test, at least 75 percent of the corporation's income must be passive income (e.g., dividends, interest, rents and royalties, as discussed above). Under the asset test, at least 50 percent of the corporation's assets must be held for the production of passive income.

If either test is met, regardless of their percentage ownership in a PFIC, the U.S. shareholders must either elect to include in income annually their share of the PFIC's earnings, or be charged interest on the amount of tax due when a large distribution is received or the shares of the PFIC are sold at a gain. All calculations are made using U.S. tax accounting principles in U.S. dollars.

## **Federal Reporting of Foreign Investment in the U.S.**

The U.S. Commerce and Agricultural Departments require a foreign investor to report information about his or her investments, unless the exceptions for small investments are applicable. Reporting is required when a U.S. entity is established or acquired, and may be required thereafter on a quarterly or annual basis. A benchmark survey is also performed every five years. The information gathered is kept confidential and is only used for analytical and statistical purposes.

## **Foreign Bank Account Reporting**

Each U.S. person who has a financial interest in or signature authority, or other authority over any financial accounts, including bank, securities or other types of financial accounts in a foreign country, must annually report details of the accounts to the U.S. Department of the Treasury if the aggregate value of the financial accounts exceeds \$10,000 at any time during the calendar year. This information is reported on Form TD F 90-22.1 and is due by June 30 of the following year. The term "U.S. person" includes a U.S. citizen or U.S. resident individual, a U.S. corporation, a U.S. partnership, or a U.S. estate or trust.

## **Distributions and Dividends**

Corporate distributions are first considered taxable dividends under U.S. tax principles to the extent of the corporation's "earnings and profits" (E&P). Distributions in excess of E&P are tax-free returns of capital to the extent of the shareholder's basis in its shares. Distributions in excess of basis are considered capital gains, which may or may not be taxable to a foreign person. E&P is primarily the corporation's cumulative taxable income plus certain adjustments. It is not identical to "earned surplus" or "retained earnings."

## Thin Capitalization

The classification of a corporate obligation as debt or equity is of great importance in U.S. corporate taxation. Only interest is deductible against taxable income by the paying corporation. The retirement of a debt instrument is usually tax free, but the redemption of stock is generally taxable to the recipient. Treating an obligation as debt or equity is often critical in determining which of several provisions of U.S. tax law apply. Unlike many other jurisdictions, U.S. tax law in this area is generally substance based. Thus, in order to determine the federal tax implications, the substance of an obligation (which may differ from its form) must be carefully evaluated before a transaction is consummated.

A U.S. tax deduction may be deferred for interest accrued by a corporation to a related person (generally a 50 percent or greater shareholder) that is not fully subject to U.S. income tax on the interest income. The deduction for interest paid to third parties may be deferred if the indebtedness is guaranteed in any way, directly or indirectly, by a foreign related person. A deduction for interest that is deferred is carried forward and may be deducted in future years. This “earnings stripping” provision applies when the U.S. corporation realizes tax losses or limited amounts of taxable income, or when the U.S. corporation’s debt-to-equity ratio exceeds 1.5:1. Interest paid that is exempt from tax or subject to a treaty-reduced tax rate is subject to these deferral provisions.

## Corporate Liquidations

A corporate distribution to its shareholders in complete liquidation is generally treated as a sale or exchange by the shareholders of a capital asset. Except in the case of a U.S. real property interest, a foreign shareholder is generally not subject to U.S. taxation on the receipt of liquidating distributions or any other capital gains.

The liquidating corporation generally recognizes gain or loss on a distribution of its assets in complete liquidation or on the sale of its assets in conjunction with a complete liquidation. An exception applies for the liquidation of subsidiaries; the liquidating corporation and its 80 percent or greater corporate shareholder generally do not recognize gain or loss upon such a liquidating distribution. However, the liquidating corporation does generally recognize gain or loss if the parent corporate shareholder is foreign.

## **State and Local Governmental Incentives**

State and Local governments have historically provided various incentives to businesses in an attempt to induce them to locate in their business in a particular area. These incentives are generally tied to the number of jobs a business will create and have taken the form of a reduction in the tax rate for a specified period of time, tax credits, assistance in training the workforce, and/or property tax reductions or exemptions. These incentives may not even be publicized. Learning about these incentives and obtaining them often involves contacting the appropriate state and local governments for details and negotiating with them to obtain the subsidy.

## 11. Personal Income Taxation

For 2005, the U.S. imposes a maximum individual income tax rate of 35 percent on ordinary income. The rates have recently been changing with an increased frequency. In addition, several major changes are currently being contemplated.

For 2005, taxable income of a single individual—excluding net long-term capital gains—is subject to federal individual income tax at graduated rates, as follows:

Taxable Income		Of the Amount	
Over:	But Not Over:	The Tax is:	Over:
Nil	\$7,300	10%	Nil
\$7,300	29,700	\$730 + 15%	\$7,300
29,700	71,950	4,090 + 25%	29,700
71,950	150,150	14,652 + 28%	71,950
150,150	326,450	36,548 + 33%	150,150
326,450		94,727.50 + 35%	326,450

There are separate tax rate tables for married persons filing jointly, married persons filing separately, and unmarried people with qualifying dependents (usually children) called “heads of household.”

Special advantageous rules apply to long-term capital gains (assets held more than one year), which are generally taxed at a maximum rate of 15 percent. Currently, “qualified” dividends are also subject to a maximum 15 percent rate.

An alternative minimum tax of 26 percent or 28 percent applies if a substantial amount of an individual’s deductions or income excluded from current taxation is due to “preference items,” such as a deduction for state and local income taxes, or the difference between the fair-market value and the amount paid for certain stock (i.e., “share”) options.

The U.S. taxes its citizens and permanent residents (i.e., “green card” holders) on their world-wide income regardless of where they reside. The foreign tax credit is designed to minimize the effects of any “double” taxation by the U.S. and a foreign jurisdiction.

In the year of arrival and in the year of departure, the U.S. taxes foreign individuals who move to or from the U.S. as nonresidents, part-year residents, or full-year residents. Part-year residents and full-year residents are taxed on their world-wide income during the period of residency. Nonresidents are generally taxed only on their U.S. source income. Note, however, that U.S. source income includes all income from the performance of personal services in the U.S., regardless of the residence of the payer. Thus, tax planning should occur before an individual moves to the U.S. In addition, the U.S. tax rules regarding trusts can be complex and the tax results can be surprising to foreign individuals. If applicable, the U.S. income tax rules regarding trusts should be addressed before an individual takes up U.S. residency. Special rules also apply in the year of departure, for three years thereafter, and for certain long-term permanent resident aliens, for up to ten years post-departure. Knowing the rules regarding departure can prevent unexpected taxes or consequences years later.

Individual income tax returns are almost always filed on a calendar year basis, and the tax return is due on or before April 15 of the following year. An extension of time to file can be requested. The extension is automatic and allows for a filing date of October 15. The extension is for the time to file the return; the tax estimated to be payable must be remitted with the extension. Underpayments result in the imposition of interest and possible penalties from April 15 to the date of filing. A special rule allows certain individuals who live abroad to file on June 15, but interest is charged on any underpayments from April 15. An extension is available to these foreign resident taxpayers as well. The extension must be filed by June 15 that generally allows for a filing date of October 15.

Individuals are also generally required to make estimated tax payments regarding their non-wage income. An employer is required to withhold on wages, and this withholding generally satisfies the tax liability associated with the wages. Since U.S. tax is based on aggregated results of all activity, estimates may be required. Estimated payments are due in generally equal installments on April 15, June 15, September 15, and January 15 of the next succeeding year. Individuals with significant differences in income from calendar quarter to quarter may elect to pay based upon actual taxable income each quarter.

State and local income taxes vary by location. The state rates vary from nil (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) to over 9 percent (California and Vermont). Some states replace income tax with wealth taxes (e.g., Florida), sales taxes, and/or other types of taxes. It is often important to evaluate the entire tax system of the state(s) in which the business is or will be located to quantify the tax costs of living and/or doing business in the U.S., and to perform effective tax planning. City taxes can be as high as 4.45%, such as New York City.

## 12. Estate and Gift Taxes

The U.S. has an estate and gift tax regime that applies to taxable gifts of property made by an individual during his or her life and taxable bequests made at death. The estate and gift tax regime is separate from the income tax regime. The U.S. estate and gift tax regime is assessed on the giver or transferor of the property, including the decedent, who is considered the transferor at the time of death. In general, the recipient is not taxed on the receipt of the property. The recipient is taxed under the income tax regime on the income earned by the property post-receipt, as well as the property's appreciation. In the case of an inheritance, the individual is taxed generally only from the time of receipt until sale or other disposition. The estate and gift tax is not an income tax, but rather a wealth transfer tax. For 2005, the unified rate schedule for the estate and gift tax is as follows:

<b>Column A</b>	<b>Column B</b>	<b>Column C</b>	<b>Column D</b>
<b>Taxable Income Over:</b>	<b>Taxable Amount Not Over:</b>	<b>Tax on Amount in Column A</b>	<b>Rate of Tax on Excess Over Amount In Column</b>
			<i>Percent</i>
\$0	\$10,000	\$0	18
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	1,250,000	345,800	41
1,250,000	1,500,000	448,300	43
1,500,000	2,000,000	555,800	45
2,000,000		780,800	47

There are two separate estate and gift tax regimes, one for U.S. citizens and U.S. residents, and a second regime for nonresident aliens. To further complicate matters, the definition of U.S. residency for estate and gift tax purposes is different from the definition for income tax purposes. A foreign citizen is considered a U.S. resident for estate and gift tax purposes if the individual's "domicile" is in the United States. Domicile is defined as the place where the individual resides with an intention to remain indefinitely.

## **Estate Tax**

U.S. citizens and U.S. domiciled foreign citizens are taxed at death on the fair market value of all of the decedent's world-wide assets less certain deductions. One of the deductions allowed is the marital deduction for transfers to the decedent's spouse, but only if the spouse is a U.S. citizen or if the property is transferred to a special trust for the benefit of the spouse who is a non-U.S. citizen.

Only certain property situated in the U.S. owned by a foreign citizen not domiciled in the U.S. at the time of death is subject to U.S. estate tax. Generally, stocks (i.e., "shares") and bonds of U.S. corporations, U.S. real estate, and pensions, including deferred compensation accounts are included in a U.S. estate. Deposits in a U.S. bank and proceeds from a life insurance policy are generally not included in a U.S. estate. Estate tax treaties may mitigate the inclusion of certain U.S. situated assets in a nonresident alien's gross estate. For example, several treaties exclude stock and debt of U.S. corporations owned by nonresident aliens in treaty resident countries.

The recipient's basis for U.S. income tax purposes of property transferred at death is generally stepped up to the fair market value of the property at the date of death.

## **Gift Tax**

U.S. citizens and U.S. domiciled foreign citizens are subject to estate and gift tax on the fair market value of all gifts made during a lifetime unless an exclusion exists. For example, an unlimited exclusion is available to pay for any third-party medical or educational expenses. For this exclusion to apply, the bills must be paid directly, not as reimbursements to a friend or a relative.

An individual can also make multiple gifts of \$12,000 each in 2006 to separate recipients. These gifts are not included in the total amount of the donor's taxable gifts during that year. The annual exclusion amount is indexed annually for inflation. Married couples can treat the gift as if each made one-half of the gift. Doing so can double the amount that can be transferred annually tax free to any one donee. All gifts between spouses that are both U.S. citizens are tax free. Similar rules apply to divorce settlements.

Gifts made by foreign citizens who are not domiciled or resident in the U.S. are generally exempt from U.S. gift taxes. U.S. gift tax applies only to gifts of U.S. real property and tangible personal property. Gifts of U.S. intangible property, including U.S. stocks and bonds, are generally not subject to U.S. tax.

A recipient's basis in a gift for U.S. income tax purposes is generally equal to the transferor's basis in the item prior to the gift.

U.S. Citizens and U.S. resident aliens (for income tax purposes) are not taxed on the receipt of gifts and inheritances received from foreign nationals or anyone else. However, any such transfer from a foreign national or estate over \$100,000 in any calendar year must be reported along with that year's income tax return. Failure to report foreign gifts or inheritances over \$100,000 is subject to a \$10,000 penalty per occurrence.

## **Future Legislation**

The U.S. estate and gift tax regime is under scrutiny at this time. Estate taxes are scheduled to phase out for one year (2010) and are reenacted a year later. Most professionals regard this as a deadline for change, not an event for which to plan. So it is particularly important to monitor actual and proposed legislative activity in this area.

# **Appendix A:**

## **A Select List of Valuable and Informative Websites**

Listed below are some websites that contain extensive information and further details on issues related to the U.S., particularly on matters of business, the economy, taxes and commerce. Most of these sites contain multiple links to other sources that may be helpful. Several of the sites include information in more than one language. This is by no means intended to be the definitive list of Web sites related to U.S. information. There are hundreds, even thousands, more. These are intended to narrow your search to the government-sponsored sites on the select matters contained in this guide.

[www.msnainc.org](http://www.msnainc.org) - Visit our website to find out more about Moore Stephens North America, Inc., including the services our member firms provide, and the locations of member firms.

[www.moorestephens.com](http://www.moorestephens.com) - Visit the global website to find out about our global services and the world wide locations of our member firms.

### **Other Websites**

[www.bea.gov](http://www.bea.gov) – Bureau of Economic Analysis – Look for a link to “Overview of the Economy,” a continually updated (quarterly) chart of the BEA’s various economic accounts, including Gross Domestic Product, purchases, personal income, national, state and local finance figures.

[www.census.gov](http://www.census.gov) – Bureau of the Census – Includes in-depth population figures, nationally, by state, ethnicity, etc. Includes data from most recent nationwide census (2000) as well as archival data. Also includes much economic and international trade data.

[www.dol.gov](http://www.dol.gov) – Official site of the U.S. Department of Labor includes information on workforce issues.

[www.esa.doc.gov](http://www.esa.doc.gov) – Economics and Statistics Administration

[www.fedstats.gov](http://www.fedstats.gov) – Provides access to key statistical sources within the U.S. government (multiple bureaus and agencies). Also includes a statistical profile of each state.

[www.firstgov.gov](http://www.firstgov.gov) – This is the U.S. government’s official Web portal and includes links to each of the sites below as well as many more.

[www.irs.gov](http://www.irs.gov) – Internal Revenue Service site includes a section on foreign tax information and guidance, including “Essential Concepts of International Taxation.”

[www.ita.gov](http://www.ita.gov) – International Trade Administration

[www.pcaob.com](http://www.pcaob.com) - The PCAOB is a non-profit organization created to oversee the auditors of public companies to protect the interest of investors and the general public.

[www.ustreas.gov](http://www.ustreas.gov) – In addition to accounting and budget information, includes international section with trade and market information.

## **Appendix B:**

### **A Review of the U.S. Tax System for Incoming Foreign Executives**

The following is a general outline of tax issues faced by foreign executives coming to the U.S. Often, the type of tax is blurred because the defining pronouns (federal, state, sales, FICA, etc.) that are familiar to most Americans are confusing, vague or unknown to the foreign person. These topics should be reviewed with a tax professional familiar with local customs, since there are literally tens of thousands of taxing jurisdictions with separate rules throughout the United States. Typically, only a few are visible to the taxpayer, but the person new to the system often needs to know about the taxes that are controllable and those that will affect the executive's family.

1. Income tax. Estimates to pay this tax are generally withheld from payroll by every employer whenever the company pays employee compensation. Compensation includes salary, bonus, and most fringe benefits such as housing, the personal use of employer-owned automobiles, etc.

These taxes are subtracted from each paycheck, but these "withholdings" are not tax payments; they are deposits on account. These withholdings are reported to the government when the employee files an annual income tax return reporting wages and withholdings, along with all other forms of taxable income. Some types of income are subject to withholding and some are not. All income is taxable to residents, subject to special exceptions, exclusions, deductions and credits.

Accordingly, by filing an income tax return with the annual self-assessment of tax, the employee's taxes are officially "paid" by crediting the wage withholdings along with quarterly estimated tax payments that are tendered by taxpayers who do not have sufficient overall withholdings to meet their expected tax liability. If the employee has overpaid the tax liability, a refund in cash can be requested or the employee can apply it to the next year. If the employee has underpaid the liability, the employee must pay the additional tax before April 15 to avoid expensive interest/under-payment penalties, even if an extension of time to file is requested.

The adequacy of tax payments during the year is the employee's responsibility. If he/she is underpaid, modest under-payment penalties must be paid, which are based on market interest rates. A separate tax return and accounting is prepared and submitted to each government where the employee works, lives and/or has sources of income. This includes:

- a. Federal Income Tax;
  - b. Resident State Income Tax;
  - c. Work/office State's Income Tax, if different from the employee's resident state; and
  - d. Other states/city income taxes, where applicable.
2. Payroll tax. A federal tax is paid by all employees based on wages and withheld from all compensation payments. The employer pays a matching amount. These taxes are paid and subtracted from each paycheck. This is a tax assessment and no further tax return is filed.
- a. FICA tax. This tax, which is for the U.S. retirement system, generally referred to as social security tax. It is charged at 6.2% of first \$94,200 for 2006, adjusted annually.
  - b. Medicare tax. A tax which provides health care for elderly persons, disabled workers, and certain survivors (children, spouses) of wage earners, is charged at 1.45% of all compensation.
3. Sales/use tax. Sales/use tax is commonly called "sales tax." This tax is added to the purchase price of most consumer items. It is paid by consumers, who normally do not need to file a tax return or account to the government for the tax, except under unusual circumstances. Occasionally, sales tax also applies to services.

Each U.S. state and locality uses thousands of systems and definitions of what is taxable and what is exempt. Historically, like the VAT System in Europe, most of the responsibility for calculating, collecting, and paying over the tax rests on vendors. For this reason, the sales/use tax system is somewhere from opaque to invisible to most individuals. Most tax was historically collected by businesses at the point of retail sale, and remitted to the government by the merchant.

Unlike the VAT, sales/use tax is not due with every transaction—only at the point of retail sale. There are a lot of exceptions which vary from state to state and jurisdiction to jurisdiction. Payment of the tax by the consumer at the time of purchase is generally simple and straightforward. Unfortunately, the underlying tax rules and concepts are quite complex to apply when exceptions occur and the individual becomes directly responsible for the process or the payment.

Two common traps confuse and complicate the life of the general public in this area:

- a. Real property construction or improvement is generally not subject to sales/use tax. This includes buying or remodeling a home. (Other taxes relating to buying or selling a home are discussed later as Real Property and Transfer Taxes.) Instead, someone, usually the vendor/contractor, must pay tax on the purchase of materials used to make the improvements. The sale of the materials to the person making the capital improvement is considered a taxable sale to the end user. Since material cost is a small fraction of home construction/renovation costs compared to labor and contractor's profit, this is a good deal and a savings.
  - b. Purchases made outside of the purchaser's home state are generally subject to sales/use tax if the out-of-state vendor does not collect the taxes at the point of sale. Examples: (1) a purchaser living in New York makes a purchase through the internet from a vendor located solely in Texas that ships the purchased goods to New York; (2) a New York resident purchases clothing from a store while on vacation in Las Vegas, Nevada; (3) a New York resident purchases items during a business trip in France. All of these purchases are fully taxable in New York. A credit is generally given if the vendor collected sales/use tax in another state, but not for foreign VAT. These sales/use taxes were largely uncollected for years, but the explosion of internet and catalog shopping in the past 20 years has cost states meaningful amounts of lost tax revenues. Thus, state tax collectors are now aggressively pursuing these revenues. Many states, such as New York, have added a line to their individual income tax returns (See 1.b. above) to collect this tax. Other states require a separate set of forms to self-assess and remit tax, quarterly or annually.
4. Real Property Tax. Real property tax is commonly referred to as "real estate tax" and is charged to owners of real property. For example, homeowners are taxed annually by the community they live in so that the local government can to provide local service such as schools, fire, police, etc.

These taxes are prorated when a house is purchased or sold. Thereafter the owner receives a bill from the local community once or twice a year and must make the payment directly. Sometimes, the payments can be made quarterly. It is important to pay these bills on time as they are completely the homeowner's responsibility, even if the government forgets to send the bill or does not change its records from the old to the new owner. Each homeowner should actively monitor this, especially when changes occur.

Some mortgage companies take on the responsibility of paying real estate taxes because the government's lien for real estate taxes is superior to their claim. The mortgage company collects payments from the homeowner, holds them in escrow and pays the bills when due. Escrow statements should be reviewed annually when this system is being used to make sure transactions are being handled correctly, especially because paying the mortgage company may not relieve the homeowner of the liability (for example, if the mortgage company does not pay the local government).

5. Personal property tax. Some states such as Connecticut have an annual personal property tax on some important, expensive items such as automobiles. Often, states will mail out partially completed forms for taxpayers to self-assess. People in these states need to be aware of the tax and their responsibility.
6. Transfer tax. Transfer tax and mortgage recording taxes are common fees charged in connection with the purchase and sale of a home or other real property. These are calculated and paid as part of the purchase or sale transaction and should be reviewed with a representative in connection with the transaction.
7. Excise and other taxes. There are a lot of other minor taxes, customs duties, and transaction fees charged by the various governments that all co-exist in the United States. Generally, the responsibility for payment of these items vests with the manufacturer or merchant, and they are invisible to the consumer and require no other action other than paying the bill from the vendor. The vendor adds the charges for these items to the cost of the products, as is the case with any airline ticket or telephone bill. Others are not covered here because they are limited to a very few jurisdictions. The rules of every state one lives, works or has business in should be checked.

## Appendix C:

### U.S. Immigration Options for Hiring and Transferring Foreign Personnel

One of the critical concerns of foreign-owned companies establishing U.S. operations and of U.S. businesses with operations overseas is the speed and certainty with which the U.S. immigration process can be facilitated for executives, managers and key employees. This concern is shared by domestic companies hiring foreign nationals. With advance planning, companies should find U.S. immigration laws flexible enough to meet their needs in most cases. There are a number of available visa options that allow employment of foreign nationals in the United States.

Each visa option should be considered in light of the following issues:

- Whether overseas operations are required
- Importance of ownership of the company
- Type of position offered
- Employee background required
- Salary offered
- Length of need of employee in the United States
- Timing of obtaining visa

It is prudent for employers to use the services of U.S. immigration lawyers experienced in dealing with business immigration issues to navigate through this process and to provide advice regarding the best options for particular needs, possible hurdles, risks, timing and other issues.

The following does not purport to address all types of visas, but shows the more common ones.

#### **L-1 (Intracompany Transferee) Visa**

The L-1 visa enables overseas companies with parents, subsidiaries, affiliates or branch offices in the United States to transfer managers, executives, and “specialized knowledge” employees to the United States. The employee must have been employed abroad in a managerial, executive or specialized knowledge capacity during one of the last three years prior to transfer in an office of the foreign company, and must be

employed by the same company, or a parent, subsidiary or affiliate, as a manager, executive or specialized-knowledge employee in the United States. In most (but not all) cases, there must be at least a 50% common equity interest between the foreign and U.S. companies (exceptions may exist where there is a minority equity relationship but common control). No particular salary payment is required. The company can be foreign owned or U.S. owned. No particular education background of the employee is required.

The petition is filed by the U.S. company with U.S. Citizenship and Immigration Services (USCIS). Upon approval, the petition is forwarded to the U.S. Consulate where an L-1 visa can be issued to the employee. Some companies with large multinational operations may qualify for blanket L 1 status, which enables the petition to be filed directly with the U.S. Consulate thereby bypassing the petition with USCIS. L-1 visas usually allow a three-year initial entry. One extension of stay of two years is possible for a specialized knowledge employee, while managerial and executive employees may be entitled to two separate two-year extensions. In the case of a start-up business or a company doing business for less than one year in the U.S., the initial approval is limited to one year, with possible extensions to a total of five years for specialized knowledge or seven years for managers and executives.

USCIS is required by law to adjudicate L-1 petitions within 30 days. Employers can pay an additional \$1000 premium processing fee to be guaranteed a review of the petition within 15 days or less.

## **E-1 and E-2 Visas**

The E-1 treaty trader visa and the E-2 treaty investor visa are only available to employees of companies owned at least 50% by nationals of a country that has a special treaty relationship with the United States or to individuals who are nationals of the treaty country. The E-1 visa is an option for companies or individuals engaged in substantial import or export, a majority of which is between the United States and the country of nationality of at least 50% of the owners of the company. The E-2 visa is available to companies which have invested a substantial amount of capital in U.S. operations. Such companies are allowed to transfer executives, supervisors, and “essential skill” employees to U.S. operations if such employees are of the same nationality. The E-2 visa is also available to individual nationals of a treaty country who make a substantial active investment in an enterprise which creates job opportunities if they come to the U.S. to direct the investment.

Neither substantial trade nor substantial investment is subject to exact definition. Substantial trade takes into account both volume and dollar value of the transactions and substantial investment looks at the amount necessary to create a viable enterprise in the United States and the percentage of the investment by the foreign entity compared to the total investment in the U.S. entity.

The employee to be transferred does not have to have worked for the company overseas. No particular education or experience is required of the employee. There is also no salary test.

Applications can be made directly to the U.S. Consulate without any pre-approval by USCIS. As a general rule, where a company is making the investment, the Consulate will first approve the company as a treaty company, and then review the application of the individual employee seeking transfer. Once the company is certified, individual employees can apply directly at the U.S. Consulate. Visas are usually issued for five years, although shorter periods may be dictated by reciprocity limitations with certain countries or at the discretion of the U.S. Consulate. Each single admission to the United States is limited to two years, with an indefinite number of two-year extensions possible.

## **H-1B Visas**

The H-1B visa is available to an employee who is offered a position that requires a U.S. bachelors or higher degree as a minimum qualification. In addition, the employee must have a U.S. or foreign equivalent degree, or a combination of education and experience that is equivalent to the required degree. The H-1B visa is available to multinational companies and purely domestic U.S. companies irrespective of ownership.

The process is initiated by the company filing with the Department of Labor (DOL) a labor condition application attesting that the employee will be paid the higher of the actual wage paid to other similarly situated employees or the “prevailing wage”. The prevailing wage is determined by accessing government or private compensation surveys to determine the average wage paid to U.S. workers by other companies in the geographic area. The second step is the filing of a petition with USCIS. Upon approval, the employee may apply for the H-1B visa at the U.S. Consulate. The normal processing time is often four to five months, although companies can obtain approval within fifteen days or less by paying the premium processing fee. Initial entry is limited to three years, and one extension of stay for a maximum of three more years is possible

The H-1B visa is subject to a more complex regulatory scheme, with more potential liabilities to employers, than with other visa categories. Employers must maintain a file available for public inspection containing certain information relating to the employment of the H-1B foreign national. Notice of the filing must be provided to the collective bargaining representative or, in the absence of a collective bargaining representative, notice must be posted in conspicuous locations where H-1B employees will be employed. The employer must agree to pay the return cost of transportation of the foreign national to his or her home country in the event that the foreign national is terminated prior to the conclusion of the approved H-1B period and assuming the foreign national opts to leave the United States.

Under a concept called H-1B portability, employers can commence the employment of applicants for H-1B status upon the filing of the H-1B petition if the employee was previously in H-1B status. In all other cases involving initial H-1Bs (or any other visas), the employment cannot commence until the petition is approved.

Unlike the other visa categories discussed above, there is an annual quota on H-1B visa issuance. Once the annual quota is reached, companies may not be able to obtain H-1B visas for employees who were not previously in H-1B status for many months until the next year's quota becomes available on October 1.

## **B-1 Visa**

The B-1, or visitor for business, visa is a valuable option for short term transfers or where speed of transfer is of the essence. The employee must continue to be employed and paid by the company outside of the United States during the employee's temporary assignment in the United States. Examples of appropriate B-1 visa usage are employees exploring the feasibility of U.S. operations, performing liaison functions, obtaining information, investigating investment opportunities, taking projects back to the home country, and the like. All remuneration (except for reimbursement of expenses) must be paid by the overseas company, and the foreign employee cannot be engaged in day-to-day employment responsibilities in the United States other than for the benefit of the overseas company.

The advantage of the B-1 visa is that it can generally be obtained very promptly at a U.S. Consulate. No petition filed with USCIS is required. Nationals of certain countries are exempt from the necessity of obtaining a B-1 visa, and can enter the United States without a visa for up to three months at a time.

Foreign nationals entering under B-1 visas or without a visa are often subject to greater scrutiny at the U.S. port of entry. It is prudent for such individuals to carry a letter from the company explaining the need for them to come to the United States and the fact that they will not be employed or paid in the United States. Foreign nationals entering without a visa cannot obtain an extension beyond ninety days. A foreign national entering with a B-1 visa is normally admitted for six months or less at a time and can apply for an extension in the United States if necessary.

## **Practical Training**

Students in F-1 (student) or J-1 (exchange visitor) status may be entitled to practical training with the approval of the designated school official. Following completion of studies, F-1 students may obtain twelve months practical training; and J-1 exchange visitors may receive eighteen months of practical training. Practical training is approved by USCIS, which issues an employment authorization document. No action is required on the part of the employer. Since the practical training is not extendable, employers who wish to continue the employment of a student with practical training generally must initiate the H-1B process prior to the conclusion of the practical training.

## **H-2B Temporary Workers**

The H-2B visa is available for employees coming to undertake trainer or other positions in the United States which by their very nature are temporary. The company must first satisfy DOL that there are no qualified U.S. workers available and interested in the position by engaging in necessary advertising. The company must also satisfy DOL that the prevailing wage will be paid to the foreign worker. Upon certification by DOL, a petition may be filed with USCIS. Upon approval, the employee may apply for visa issuance at the U.S. Consulate. Initial entry is limited to one year, with two one year extensions possible, but difficult, to obtain. The H-2B visa is appropriate for seasonal employees, peak-load employees, and other employees who will not need to be replaced upon the conclusion of their temporary employment. There is an annual quota on H-2B visas, so that such visas may not be available during certain parts of the year.

## **H-3 Visa**

The H-3 visa is for employees being sent to the U.S. for training where any productive employment is incidental to such training. The training must equip the employee to work overseas and must generally be unavailable in the home country. The petition is filed directly with USCIS with no DOL involvement required. There is no prevailing wage requirement. Entry is limited to two years.

## **J-1 Exchange Visitor Visa**

This visa must be sponsored by an entity approved by the U.S. Department of State. Universities, hospitals, and companies can obtain such approval after an often lengthy application process. Alternatively, U.S. companies can pay an application fee to companies who have already been approved by the Department of State and who are eligible to act as “third-party sponsors” for training programs conducted by non-approved companies. J-1 visas are issued to students, trainees, scholars, researchers, professors, and others for varying periods of stay. Trainees are generally limited to eighteen months, and researchers are generally limited to five years. The sponsoring entity issues a DS-2019 Form to the employee, who applies directly at the U.S. Consulate. Some employees who enter on J-1 visas are subject to a requirement that they return to their home country for two years.

## **O-1 visa**

Foreign nationals with “sustained national or international acclaim and recognition” may qualify for O-1 extraordinary ability classification. This visa requires proof that the foreign national has a reputation for being “one of a few at the top” of his or her specific field of expertise. This can be proven by a combination of documents and reference letters. The employer files with USCIS a petition, which is eligible for premium processing consideration. The O-1 visa can be issued for three years with unlimited numbers of one year extensions possible.

## **TN-1**

A Canadian or Mexican national may be able to obtain TN-1 status if his or her occupation appears on a schedule of occupations included in the North American Free Trade Agreement. Most of these occupations require an educational background of bachelor level or higher. TN-1 status can be granted at the port of entry without a pre-approved petition. If approved, TN-1 status is granted for one year. Unlimited numbers of extensions either at the port of entry, or at USCIS, are possible, although TN-1 status is considered temporary and can be denied if it appears that a foreign national employee has abandoned his intention to return to a foreign residence.

## **Spouses**

Each visa category allows spouses and children (under 21) to enter the U.S. for the same length of time as the principal. Spouses of L-1s, E-1s, E-2s and J-1s can obtain work documents. Other spouses cannot work unless they are sponsored by their own employers for one of the listed working visa statuses.

## **Permanent Residence Status**

Some employees transferred to the United States will wish to become U.S. permanent residents. The advantage of permanent residence status is that it enables the individual to remain permanently (or as long as he or she wishes) in the U.S. without having to apply for visas or extensions.

Most non-managerial employees are required to go through a process called a labor certification application as the first step in becoming a permanent resident. This process requires recruitment efforts on behalf of the employer and proof that no qualified U.S. worker is available to fill the position.

Two categories of employees are exempt from this requirement. Managerial and executive level transferees may obtain permanent resident status through a petition filed by the employer directly with USCIS. If the requisite corporate relationship exists, and the employee was employed as a manager or executive overseas and as a manager or executive with the related company in the U.S., the individual can be approved as a multinational manager or executive, and, based upon that classification, apply for permanent residence status.

Other employees who do not have to go through the labor certification process are “aliens of extraordinary ability” and aliens with advanced degrees or “exceptional ability” performing services in the national interest of the United States. In these instances, the company or the individual employee can file a petition with USCIS, and, upon approval, obtain permanent resident status.

All employees applying for permanent resident status are subject to immigrant quotas. These quotas vary by country, by type of application and by level of education required for the position. In some cases, the quota will be current, meaning there will be no delay. In other cases, the quota may result in multiple year delays in the permanent residence process.

## **Travel Issues**

A key concern for companies transferring personnel is assurance that their employees do not encounter problems traveling in and out of the United States. Holders of H-1B, L-1, E-1, E-2 and O-1 visas are not subject to the requirement of proving that they have a residence overseas to which they intend to return. Other visa categories have this requirement.

Especially since September 11, 2001, security clearances may result in delays in the visa issuance process. Sometimes these delays are predictable, and sometimes they are unforeseen. In addition to security clearance delays, U.S. Consulates now require personal interviews of all applicants. This has resulted in lengthy delays in obtaining appointments for visa issuance at some U.S. Consulates.

Appendix C was contributed by Ron Klasko, Esq. Mr. Klasko ([rklasko@klaskolaw.com](mailto:rklasko@klaskolaw.com)) is a Philadelphia-based member of the Academy of Business Immigration Lawyers, a coalition of leading immigration attorneys concentrating on servicing the international business community.

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