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# Expanding into the U.S. – The U.S. Issues

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## Expanding into the U.S. - Scope

- General Issues
  - Selling in U.S. markets
  - Non-tax compliance requirements
  - Banking arrangements
  - Choice of entity
- Operational Issues
  - Buying versus leasing business premises
  - Tax issues :
    - Permanent establishment
    - Federal taxes
    - State and local taxes
    - Transfer pricing
  - Employees in the U.S.
- Pitfalls



## Expanding into the U.S. – Selling in U.S. Markets

- Required permits to sell in many jurisdictions (not all centralized)
- Regulatory agencies at federal, state & local levels
- Business licenses (state & local)
- Taxes
  - Difference levels of taxation & reporting create complexity
  - Difference thresholds for various taxes





## Non-Tax Compliance Requirements

- Depends on location of formation and type of entity
- Incorporation – certificate of incorporation sets forth requirements for governance
  - Does not need to be formed in state of residency
  - Annual shareholder meetings usually required to elect directors
  - Board of directors may not be required, but practical
  - Directors generally not required to be a shareholder
  - Local or resident directors may be required
- Filing with state of incorporation – usually an annual filing fee
- Statutory audited financial statements are not required, except for certain regulated industries (ie. public companies, banks, insurance, regulated investment companies)
- Creditors and vendors may require audited statements
- SAS 70 – Audit procedures for service organizations who host or process data belonging to customers



## Banking Arrangements

- Do I need to open a US account?
- Patriot Act requirements
  - Financial institutions must take reasonable steps to identify beneficial owners of accounts
  - Customer identification rules are implemented
  - “Customer” is defined as a person with a deposit account, loan account, other account or receiving other bank services
  - Required to obtain and verify: name, address, date of birth, taxpayer ID number
    - If foreign person has no US identification number, a similar foreign government issued ID number may suffice
  - Verification of identification
    - Documents for partnerships, corporations, not-for-profits, branches
    - Identification of person with authority or control over these entities
- Note: Electronic payment required for federal tax payments must be from a U.S. bank account; must be set up prior to first payment due date



# Choice of Entity

- Depends on Local Entity Law
- Defined
  - Corporation
  - Partnership
  - Limited Liability Company; Limited Liability Partnership
  - Branch or Disregarded entity
  - Not for Profit
- Use of U.S. “check the box” rules (choice of entity election) to define entity status for U.S. only (see slide 9)
  - May differ from host country
  - Check the box election under Sec. 7701
- Income tax treaties



## Choice of Entity - Corporation

- Cost of incorporation, on-going filing requirements, and other non-tax considerations
- Capitalization requirements (debt-to-equity ratio)
- Management fee charges allowed to reduce income
- Transfer pricing considerations
- Anti-deferral provisions for US Corporations invested offshore
- Utilization of foreign tax credits
- Foreign currency transactions
- U.S. filing & withholding requirements



## Choice of Entity - Other

- Form of partnership, LLC, disregarded or other pass-through
  - Federal, state & local taxes apply to owners who are “engaged in a U.S. trade or business”
  - U.S. “branch profits tax” may apply
  - Ability to use losses (carryforward or carryback) in foreign jurisdiction
  - Cost to set up (usually cheaper than incorporation)
  - Management fee charges allowed to reduce income



## Choice of Entity – “Check the Box” Election

- Under Sec. 7701, you can “check the box” to elect entity status:
  - Corporation
  - Partnership
  - Single member disregarded
- Requirements:
  - A separate entity must exist for federal tax purposes
  - Must be a business entity
- Default classification if fail to make election
- Subsequent election – tax consequences (ie. liquidation)
- Form 8832 – Election form
  - Can be made retroactively effective up to 75 days before election made
  - Change can not be made for 5 years
  - Relief for late election available under Rev. Proc. 2009-41



# Buying vs. Leasing Business Premises

- **Buying:**
  - Depreciation expense deduction available for owner of real and personal property
  - Accelerated depreciation and “bonus depreciation” may be available (state tax rules may limit or disallow bonus depreciation)
  - IRC §179 allows election to expense certain property up to US\$500,000 in current year of investment (limited to small businesses)
  - Real estate taxes assessed in most locations
- **Leasing:**
  - Single net lease (sometimes shortened to net or N)
    - Lessee is responsible for paying real estate taxes in addition to base rent
  - Double net lease (net-net or NN)
    - Lessee is responsible for real estate taxes and building insurance. The landlord is responsible for structural repairs and common area maintenance in addition to base rent
  - Triple net lease (net-net or NNN)
    - Lessee is responsible for real estate taxes, building insurance, and maintenance in addition to base rent
    - This makes the cost similar to buying, without the advantage of value appreciation



## Permanent Establishment for Tax Liability

- Treaty defines PE: Varies from Treaty to Treaty
  - Generally, under the US-UK Treaty
    - Fixed place of business (eg. factory or office) through which the business of an enterprise is carried on.
      - Ownership irrelevant: Has the premises on a constant basis
    - Building site or installation project if > 12 months in duration
    - Agent acting on behalf of
      - If concluding contracts in the name of foreign principal and habitually exercises that authority
      - Acts dependently on foreign principal
      - Not merely acting in ordinary course of business (ie. soliciting sales)
    - Subsidiary: does not automatically create PE for parent



## Inbound Investment – Federal Taxation

- U.S. taxpayers are subject to tax on worldwide income
- Nonresident aliens and Foreign corporations NOT subject to U.S. taxation on worldwide income
  - Source-based approach (“Territorial”)
    - ❖ U.S. sourced income: taxing mechanism depends on type of entity, income and activities in U.S.
      - For example, a partner in U.S. partnership (or foreign partnership with U.S. income) is considered “engaged in U.S. business”
  - Income “effectively connected” with conduct of U.S. trade or business
    - ❖ Presence or regular business activity in U.S.
    - ❖ Taxed on net (after deductions) basis at graduated rates
    - ❖ Special rules for sale of real estate (FIRPTA rules)
  - U.S. Sourced non-business income (“FDAP”)
    - ❖ Investment Income such as interest, dividends, rents, royalties
    - ❖ Subject to 30% withholding rate, absent treaty provision or exceptions



## Inbound Investment – Federal Taxation (cont.)

- Foreign Corporation:
  - Files U.S. return if engaged in a U.S. trade or business
    - Form 1120F
  - Information filing with U.S. return
    - Form 5472
  - Special “Branch profits tax” rules may apply (§884)
- Foreign Partner in U.S. Partnership
  - Considered engaged in U.S. trade or business for purposes of filing a U.S. return
  - Withholding tax required on foreign partner’s distributive shares of U.S. ECI of partnership at highest graduated rate of each partner (eg. 35% for a corporate partner)
  - This withholding is required regardless of actual distributions



# Inbound Investment – Federal Taxation of Investment in U.S. Real Property

- Rental Income
  - Effectively connected income if engaged in U.S. trade or business (allowed deductions)
  - Not ECI - gross rental income taxed at 30% withholding rate
  - Foreign investor can elect to treat rental income as ECI to get offsetting deductions (and no withholding on gross rental income)
- Foreign Investment in Real Property Rules (“FIRPTA”)
  - Rules designed to ensure U.S. tax on gains from disposition of U.S. real property (treated as “Effectively Connected Income”)
  - Applies to real property located in U.S. or U.S. Virgin Islands
  - Applies to U.S. Real Property Holding Corporation (“USRPHC”)
  - Disposition by foreign person (an affidavit may be required by seller)
    - 10% withholding required by U.S. purchaser on **gross amount realized**
    - Certain reporting is required: Forms 8288, 8288-A, 8288-B
  - NOTE: these rules override otherwise applicable non-recognition rules in liquidations, exchanges, reorganizations, etc.



## Withholding Taxes – U.S.

- Withholding on payment of fixed, determinable, periodic income
  - Does not apply to Effectively Connected Income (“ECI”)
  - Does not apply to Portfolio Interest
  - Currently 30%, unless reduced by treaty
- Reduction (or exemption from withholding) must be requested by filing form:
  - W-8BEN
  - W-8ECI
- Pay & report tax withholding for Form 1042 reporting
- Annual reporting – Form 1042
- Recall rule to withhold on foreign partner of with U.S. ECI



## State and Local Taxes

- Income/Franchise/Gross Receipts Tax
- Sales and Use Tax
- Personal Property Tax
- Real Property Tax
- Employer Withholding Tax
- Unemployment Tax (Federal & State)
- ❖ Note: Tax incentives may be available to reduce liability for certain types of businesses in geographic locations



## Income/Franchise/Gross Receipts Tax

- Income based taxes can be levied by not only the states, but also the county and city governments as well depending upon the jurisdiction.
- Franchise tax is based upon the value of the business within a particular taxing jurisdiction.
- Gross Receipts tax is a tax based upon the volume of sales into a taxing jurisdiction, regardless if a company is profitable.
- Approximately 47 states and countless local jurisdictions impose either an income/franchise or gross receipts tax.



## Sales and Use Tax

- Sales and use taxes are a tax that usually falls upon the consumer of a good or service. Although the tax is usually levied against tangible personal property, certain states do tax selected services.
- Approximately 45 states plus the District of Columbia levy some sort of sales and use tax.
- Tax rates can vary by local jurisdiction.



## Transfer Pricing - Overview

- IRC §482 authorizes 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 Regs under §482 imposes an arm's length standard on transactions between related taxpayers (how unrelated parties would structure or negotiate the transaction in an uncontrolled environment)
- Rules are broad in scope, leaving IRS great latitude in making any necessary reallocations
- Currently a mandatory IRS audit issue (must produce documentation in 30 days)
- Required disclosure of inter-company transactions on Forms 5471, 5472, 8865 and 8858



# Transfer Pricing – Required Documentation

- Reports should include:
  - Overview of Taxpayer’s Business
  - Description of Organizational Structure
  - Description of Best Method Selected
  - Description of Methods Not Selected
  - Description of Controlled Transaction
  - Description of Comparables Selected
  - Explanation of Economic Analysis
  - Index of Principal & Background Documentation
- Penalties (§6662)
  - Substantial valuation misstatement = 20% of adjustment
  - Gross valuation misstatement = 40% of adjustment



## Employee in the U.S.

- Generally, employing person in U.S.
  - Work permits for foreign nationals working in U.S.
  - No wage requirement to pay “13<sup>th</sup>” month or bonus
  - Healthcare considerations?
  - Employment taxes
- Foreign nationals working in the U.S.
  - Treaty allows UK resident to work in US for up to 183 days without tax liability
    - If paid by non-US resident with no permanent establishment
  - Green card = “U.S. resident” for tax purposes
    - Subject to tax on worldwide income
  - Totalization agreement between U.S. and UK (Social Security Tax Treaty)
    - Allows UK national to be exempt from US social security if proper certificate of coverage is obtained
      - Subject to UK social insurance program while working in US
      - Less than 60 month assignment (extensions may be obtained)



## Pitfalls of Doing Business in the U.S.

- High tax rate
- Multiple state filings
- Many layers of complexity
  - Regulatory, licensure, tax systems
  - Over 7,700 tax jurisdictions
- Sarbanes-Oxley Act (“SOX”) – requires public companies and certain industries to certify compliance with internal control procedures designed to protect investors and other at risk parties





## How Schneider Downs & Co. Can Assist

- Offices in Pittsburgh, PA and Columbus, Ohio with 350+ employees
- Offer a wide range of services
  - Business Assurance (audit)
  - Tax (international, federal, state & local, sales & use, customs & excise)
  - Business Advisory & Valuation
  - Corporate Finance (financial modeling) & Due Diligence
  - Buy/Sell agreements
  - Debt/Capital offerings
  - Employee Benefits Consulting
  - Wealth Management
- Tax Specific
  - Inbound tax planning, including acquisition or franchising
  - Repatriation and exit strategies
  - Withholding tax issues
  - Permanent establishment issues
  - Employment taxes, employee taxation issues (expatriate)
  - Financial modeling
  - Due diligence



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