# CHAPTER 1
# ESTABLISHING A NEW BUSINESS IN THE UNITED STATES

## 1. CHOICE OF ENTITY

A foreign investor may choose from a variety of forms of entities to do business in the United States. Such forms of entities include a corporation, a limited liability company ("LLC"), a partnership, and a sole proprietorship. In addition, a foreign investor may enter into a joint venture agreement with a U.S. business. A joint venture is generally a business entity formed by two or more non-affiliated persons, and can take the form of a corporation, an LLC, or a partnership.[1]

Selection of the form of entity requires consideration of many different factors, such as limitation of liability and taxation. A single individual investor may choose to establish a "sole proprietorship," or with one or more other individuals, a "partnership." In either case, the individual actively involved will typically be responsible for all of the liabilities of the business.[2] Similarly, a foreign company may choose to establish a branch office of its business in the United States, but the foreign corporation will be subject to lawsuits and liabilities, as well as U.S. taxation.

Typically, foreign investors choose one of two forms of business structures available in the United States: (a) corporations or (b) limited liability companies. These legal forms allow the owners to limit or distribute the risks of the business, limit tax liability and filing obligations, provide for a more sophisticated form of management, make liquidating investments easier, and attract investment from other investors. The following provides a brief discussion of these two forms of business entities.

### A. Corporations

#### (1) <u>Major Characteristics of Corporations</u>

The corporation is a legal entity separate from its owners (the shareholders). The main reasons for using a corporation to conduct business are to limit liabilities, and to provide a framework for attracting capital to the company by the sale of shares.

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1 There are also contractual joint ventures, but, for a number of reasons, these are typically not employed in a cross-border context unless each party also forms a separate entity through which each party will enter into such agreement.

2 Limited liability partnerships allow a partnership structure, without having the partners be personally responsible for the liabilities of the business. Likewise, limited partnerships, which have both general and limited partners, allow investment without having the limited partners be personally responsible for the liabilities of the business. But, as noted below, neither of these structures are typically employed in a cross-border context due to their tax consequences.

Generally, shareholders of a corporation are not personally liable for the debts of the corporation, and their liability is limited to their capital contribution in the corporation.[3]

In addition to the characteristic of limited liability, other major characteristics of a corporation include (a) centralized management, (b) relatively free transferability of ownership interests, and (c) perpetual existence.

Typically, the management power of a corporation is centralized in its Board of Directors. Directors are elected by the shareholders of the corporation. The Board then establishes corporate policy and has overall responsibility for the corporation's affairs. The Board appoints officers, who are expected to execute the Board's vision, and delegates to the officers the day-to-day operations of the corporation. However, the directors cannot transfer their responsibility for the corporation to the officers, even if they delegate certain operational tasks. Directors and officers owe independent fiduciary duties (including, the duty of care and duty of loyalty) to the corporation and to its shareholders. Directors and officers who breach their fiduciary duties may be held personally liable for their conduct. Certain major decisions involving change to the corporation can require shareholder approval, but otherwise only the Board of Directors need approve significant corporate actions, policies, or business decisions.

The ownership interest of a corporation is represented by shares of capital stock. Subject to limitations in shareholders' agreements and compliance with applicable local and federal securities laws, shareholders are free to transfer their shares.

A corporation enjoys perpetual existence unless otherwise specified in its articles of incorporation. A corporation continues to exist despite changes in its shareholders. For example, the insolvency or death of a shareholder does not dissolve a corporation.

**(2) <u>Forming a Corporation</u>**

The process of forming a new corporation in the United States is speedy and inexpensive. A number of follow-up actions must be completed after incorporation before a business can begin operations, but the actual

[3] Under certain circumstances, shareholders of a corporation may be held liable for the corporation's liabilities. When this happens, it is called "piercing the corporate veil." Courts have considered the following factors to decide whether to pierce the corporate veil: (a) failure to maintain corporate records, or comply with corporate formalities; (b) commingling of funds and assets; (c) failure to maintain the separate existence of the corporation, for example, by one corporation so controlling another that they are one and the same; and (d) failure to adequately capitalize the corporation, under circumstances so extreme that they amount to fraud or other improper dealings with creditors.

incorporation process typically takes only a few days. The filing fee is usually several hundred dollars, but sometimes can be less. For example, in Oregon, the filing fee to incorporate is only $100 per entity. Expedited service may be available in some states for a nominal fee. For instance, the Corporations Division of the Washington Secretary of State offers an expedited service for an additional fee of $20 per entity.

**(3) <u>Purpose or Business Scope</u>**

In the past, a U.S. corporation's purposes had to be stated in specific details, and a corporation could not act beyond its stated purposes or powers, just as is true in many countries like Japan and China. Under current law, however, a corporation in the United States can typically be formed to "engage in any lawful business" unless a more limited purpose is set forth in its articles of incorporation. For instance, a local manufacturing company can engage in domestic or international trade without the need to incorporate another trading company. It is not necessary to list each specific intended purpose in the corporation's articles of incorporation at the time of formation. But it may be necessary to provide a general description of the corporation's business in certain annual filings.

**(4) <u>Capital Requirements</u>**

There is generally no minimum capital requirement for forming a new corporation in the United States. Therefore, one can start a corporation with a nominal capital of, for example, $1,000. Additional capital can be paid in later if and when necessary. The primary limit on this flexibility is that undercapitalization can trigger liability for shareholders (see footnote 3). An incorporator should therefore always seek to adequately capitalize a corporation for the business activities that are contemplated.

In the United States, the simplest and most typical initial capital stock of a corporation is one class of common stock. A corporation may also issue preferred stock. Preferred stock may have a variety of preferences over common stock with respect to such matters as payment of dividends or rights upon the liquidation of the company. Both common and preferred stock can be further classified into different classes and different series within classes, each with its own special voting and other rights. Generally, state corporate statutes provide that the number of shares, common and preferred, available for issuance must be stated in the articles of incorporation. These are called "authorized" shares. Usually, the Board of Directors sets the price for shares at the time the Board authorizes shares.

## B. Limited Liability Companies

The concept of a Limited Liability Company in the United States is like a hybrid between a partnership and a corporation. It is a registered legal entity formed under a state statute that, like a corporation, limits the liability of its capital investors to their investment in the enterprise. At the same time, the tax laws governing LLCs permit the entity to be disregarded for tax purposes much like a partnership, allowing taxes to be paid only at the investor level. The applicable state statute is often called a Limited Liability Company Act. Today, every state has enacted legislation that authorizes the use of this form of entity.

Like a corporation, an LLC is a legal entity separate from the persons who own and manage it. Capital investors in an LLC are often called members. Some states require that an LLC has at least two members; other states allow one person (or entity) to own an LLC. Washington and Oregon both allow single member LLCs. Generally, there is no limit to the number of members.

The laws governing LLCs allow tremendous flexibility. For example, an LLC with two or more members may choose to be treated as a partnership or a corporation for tax purposes. If an LLC elects to be treated as a partnership, which most LLCs do, then the LLC pays no taxes at the corporate level. Instead, each member is allocated a share of the LLC's net income or loss, which the member then reports as an individual. This allocation occurs regardless of whether income is actually distributed to the member. Then, whenever money is actually distributed from the LLC, there are no taxes owing on those distributions. More information about taxation of LLCs is provided in Chapter 3.

### C. Registering a Foreign Corporation's Branch Office

As mentioned previously, a foreign corporation seeking to do business in the United States may elect not to form a new enterprise but merely register itself to operate through a branch office. This is a relatively simple process. In addition to a filing fee, the corporation will be required to submit an application to the appropriate state governmental authority, usually the Office of the Secretary of State. The application must commonly be accompanied by some proof that the corporation is in good standing in its home country.

As far as liability is concerned, the U.S. branch subjects the foreign corporation to possible claims and lawsuits in the United States. For this reason, foreign investors generally prefer to do business through a U.S. subsidiary rather than through a branch. The subsidiary helps insulate the foreign corporation from liability for the subsidiary's acts.

## 2. WHERE TO FORM

Unlike in China, Japan and any other countries, where the same national law governs operations of corporations and other legal entities throughout the country, the United States is a federation of 50 states, and each of the 50 states has its own corporate and limited liability company statute. Generally, these state statutes govern the incorporation, the structure of the Board of Directors, the shareholder power and rights, and matters relating to the internal operations of a corporation. Although the state statutes are substantially similar from state to state, there are differences in the details, which may sometimes be significant. These differences may include such areas as taxation, shareholders' voting rights, the ability to sue directors, and the extent of the directors' fiduciary duty.

The decision concerning where to establish a business usually is determined by the business owner based on the expected principal place of business. However, for a company expecting to do business in more than one state, there may be several possible locations to consider. It is important to note that an entity formed in any one of the 50 states is permitted to do business in any of the other 50 states, subject to certain registration requirements in those states where the entity is deemed to be "doing" or "transacting" business. Hence, in many instances, where to form is not of great importance to foreign investors.

Many large corporations elect to incorporate in Delaware because Delaware is perceived as favoring corporate management over shareholders. (Other large corporations, like Microsoft, later decided that incorporating in Delaware was not advantageous and reincorporated elsewhere – typically where their headquarters are located). Foreign investors sometimes favor New York and California because they are considered to be important commercial centers in the United States. More practical considerations may drive a foreign investor's decision on where to form – such as applicable state and local taxation policies and costs of doing business.

## 3. ADDITIONAL REGISTRATION AND REPORTING REQUIREMENTS

Once formed, but typically not before, a business must complete certain additional reporting and registration requirements. These vary depending on the applicable state and local laws and the type of business involved. A wide range of businesses, such as banks, beauty salons, and beer gardens, need special licenses to operate. The requirements also vary, depending on whether assets already in the United States will be acquired as part of the new business. For example, if a transaction will involve acquisition of sensitive technology, certain federal government approvals or licenses may be required. The applicable registration and reporting requirements should be investigated before forming an entity, to make sure that no separate license or approval is needed that, if not ultimately obtained, would alter a business' plans.

At a minimum, a business will typically be expected to obtain city and state business licenses, as well as registering with taxing authorities and the authorities governing employment relations in the relevant state. Sometimes states simplify this process through unified applications. In Washington State, for example, a company can start the process for any special business license, register with the Department of Revenue, register with the Department of Labor, obtain trade name registrations, and obtain general business licensure for the state and certain cities – all in one single "master business application." In the City of Portland, Oregon, any person or entity operating a business may pay a business license fee based on their net income. This fee replaces all general business taxes imposed by the city and, hence, is both a license and taxation process in one step.

In addition, under federal law, U.S. businesses (even newly formed) are required to report foreign investments in their enterprises that result in a foreign party owning a 10% or more voting interest in the enterprise. These reports are for statistical purposes only and are made to the Department of Commerce. Its regulations provide that such information will be confidential and therefore is not shared with anyone else, except in a format that does not identify the individual investors or business enterprises. The scope and detail of these reports vary depending on the size of the investment and the U.S. business. At the simplest level, the U.S. business need only disclose its name and address, the cost of the investment, the quantity of any acreage involved, the total dollar value of the business' assets, gross operating revenues and income after U.S. taxes for the immediately preceding year (or estimated year, in the case of a new company), and the country of origin of the investor and the ultimate beneficial owner.

Similarly the U.S. Department of Treasury/Internal Revenue Service expects most businesses to obtain a federal employer tax identification number and has certain on-going reporting, filing and record-keeping requirements for portfolio investments, foreign currency transactions, and transnational transactions between related companies. The extent to which any of these requirements apply to any venture will depend on the nature of the business and the types of activities undertaken.

Additional federal reporting requirements exist for transfers of agricultural land, and various restrictions can apply to industries such as transportation, fishing, minerals, energy, and banking. Finally, a new enterprise in the United States should expect regulation of its flow of personnel and goods to and from the United States by the Department of Homeland Security. As will be discussed more in other chapters, this Department is keen on better monitoring activities in and out of the United States. We anticipate that its requirements on reporting activities will be amended from time to time during the next several years.