DOING BUSINESS IN THE U.S.

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CPAs AND ADVISORS

INTRODUCTION

This booklet provides guidance for doing business in the United States (U.S.). In addition to background information on the U.S., this booklet 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, which are not covered in this guide. Unless otherwise noted, this information is believed to be accurate as of May 1, 2014. Special rules govern tax advice in the U.S., particularly when a taxpayer seeks protection for relying on advice from professionals.

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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 before any business is undertaken, advice should be obtained from local professionals, such as CPAs and lawyers.

Note: It is important to have both legal and tax professionals work together when expanding internationally to avoid potentially costly mistakes and additional expenses in the future.

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CHAPTER 1
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 and 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, limited liability companies 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 percent 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.

Limited liability companies (LLCs) are considered the most flexible type of entity for use in achieving both business and tax objectives. An LLC is a hybrid entity that provides corporate-style liability protection and partnership-style "flow through" tax treatment. "Flow through" means that the owners generally pay tax on their share of the entity's income, rather than the entity paying the tax. A corporation's profits, on the other hand, are taxed twice — once at corporate level and again at the shareholder level when the profits are distributed. In addition, LLCs can elect to be treated as partnerships or corporations for U.S. tax purposes.

This option is not available to U.S. corporations. The owners ("members") of an LLC have limited liability similar to corporate shareholders. Members may participate in the management of the company pursuant to the membership agreement. General partnerships expose all partners to unlimited liability. General partners may participate in the management of the partnership. A limited partnership requires at least one general partner who 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. In many states, legislation has been enacted to permit limited liability even to general partners (Limited Liability Partnerships or LLPs) for entities operating as general partnerships, and for all partners (Limited Liability Limited Partnerships or LLLPs) for entities operating as limited partnerships.

Trusts include the estate of a decedent and specialized entities which have aspects similar to that of partnerships (although not widely used).

Costs of Creating an Entity

The costs of creating an entity vary widely by state and by the type of 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 or cities 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 insurance coverage for the benefit of its workers. The requirements vary for each state. The requirements sometimes 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. Typically, a new corporation or Limited Liability Company can be formed in 24 to 48 hours, and in some jurisdictions, online with a credit card.

CHAPTER 2
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 100 percent owned and/or managed 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:

- 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
- Articles of Association

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

LIMITED LIABILITY COMPANIES

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. limited liability company (LLC) may be 100 percent owned 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.

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:

- Amount of each member's initial contribution to capital
- Names and addresses of each member
- 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 100 percent owned 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, a limited partnership or a limited liability 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:

- 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

CHAPTER 3
AUDIT AND ACCOUNTING

Financial Statements

The management of each business is 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 individual. In the case of a partnership or LLC, the managing partner or managing member is generally the responsible party.

Generally, the annual accounts are accepted by the owners (shareholders, partners or members) at the annual general meeting. The trustee of a trust – like a sole proprietor - has similar statutory responsibilities under the law to keep books and records.

Accounting Period

As a general rule, corporations may adopt a tax year ending on the last day of any calendar month; however, most businesses in the U.S. have calendar year-ends. 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 – Public Companies

Publicly traded companies are required to file quarterly and annual reports with the Securities and Exchange Commission (SEC). The annual reports include financial statements audited by an independent certified public accountant (CPA). The CPA must be registered with the Public Company Accounting Oversight Board (PCAOB). The interim financial statements included in the quarterly reports must be reviewed by an independent CPA.

In 2002, the U.S. Congress passed the Sarbanes-Oxley Act (SOX), which created the PCAOB and established internal control, governance and other requirements for public companies. The PCAOB establishes auditing and related attestation, quality control, ethics and independence standards and rules to be used by registered CPA firms.

Audit – Private Companies

Most private companies are not legally required to have audited financial statements. However, many private companies want or need audits to provide the highest customary level of assurance regarding the financial statements to their owners, lenders, management and other users of the financial statements. Private companies are audited by CPAs under standards established by the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA).

In lieu of an audit, the objective of which is the expression of an opinion of the financial statements taken as a whole, private companies may engage a CPA to perform a review, which consists of inquiries of company personnel and analytical procedures applied to financial data.

Another alternative for private companies is to engage a CPA to perform a compilation, which is limited to presenting in the form of financial statements information that is the representation of management. A CPA performing a compilation may or may not necessarily be independent with respect to the client.

Accounting

U.S. generally accepted accounting standards (U.S. GAAP) are principally established by the Financial Accounting Standards Board (FASB). Private companies may also prepare financial statements on other comprehensive basis of accounting (OCBOA), such as cash basis or tax basis, if such basis is acceptable for the primary users of their financial statements.

The FASB and the International Accounting Standards Board (IASB) have been working on a project to converge U.S. GAAP and IFRS, after which time the SEC will decide whether and when to incorporate IFRS into the U.S. domestic reporting system. The latest SEC statement indicates a potential implementation date of 2015 or 2016.

The SEC has recently allowed certain foreign issuers to present financial statements using IFRS without reconciliation to U.S. GAAP, and the time may be near when the SEC may allow all or require all companies, including U.S. public companies, to present their financial statements using IFRS.

CHAPTER 4
LEGAL MATTERS

VISA OPTIONS FOR FOREIGNERS TO WORK AND LIVE IN THE U.S.

By Jennifer G. Parser, Poyner Spruill LLP

There are a number of visa options for foreigners to live and work in the U.S. Following is a brief overview of the various options that exist. Since U.S. immigration laws are complex, it is necessary to consult with experienced U.S. immigration counsel to select the best and most flexible visa option in an effort to ensure the success of U.S. business ventures. Selection of the wrong visa type can have long-term adverse consequences for the employer and visa holder. This overview will start with the least permanent to most permanent options for foreign business people to come to work in the U.S.

Visa Waiver Program

The visa waiver program exists as a result of bilateral agreements between certain countries and the U.S. to permit each other's citizens to visit each other's countries without the need for a visa. Currently, there are 37 visa waiver countries whose citizens are eligible to visit the U.S. without a visa. They are: Andorra, Australia, Austria, Belgium, Brunei, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Monaco, Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Slovakia, Slovenia, Spain, South Korea, Sweden, Switzerland, Taiwan and the United Kingdom.

For a citizen from one of these countries to travel to the U.S., they must first enroll in the Electronic System for Travel Authorization, known as ESTA. ESTA is an automated system available online that determines the traveler's eligibility to enter the U.S.

ESTA applications may be submitted at any time prior to travel, although it is recommended travelers apply as early as possible.

Registration for ESTA may be made at www.cbp.gov/xp/cgov/travel/id_visa/esta/. A visitor under the visa waiver program can come to the U.S. for tourism or business purposes, such as to observe business operations, but may not engage in gainful employment capable of being done by a U.S. worker. Additionally, a visa waiver program traveler may only remain in the U.S. for up to 90 days and their stay cannot be extended from within the U.S.

B Visitor Visa

A B visa is intended for business or tourism purposes and is issued by the nearest U.S. Consulate or Embassy proximate to where the applicant lives.

It must always be obtained by citizens whose country of nationality is not eligible for the above visa waiver program, even for a short-term visit to the U.S. It is usually issued for ten years, and like a visit under the visa waiver program, the visitor must not engage in gainful employment. Unlike a visa waiver program visitor, a B visitor's stay authorized by the immigration official at the port of entry on his or her Form I-94 can be extended from within the U.S. without having to leave the country.

For the interview for a B visa at a U.S. Consulate or Embassy, the B visa applicant should have on hand the following proofs: the purpose of the intended trip, plans to remain for a specific, limited period, evidence of means to cover expenses while in the U.S., evidence of strong personal and economic ties abroad, and maintenance of a residence outside the U.S.

H-1B Visa

The H-1B visa is intended for an individual in "a specialty occupation" to live and work in the U.S. on a temporary basis. A specialty occupation has been interpreted to mean at least the equivalent of a U.S. Bachelor's Degree. If educated abroad, the visa applicant's credentials must be evaluated by a United States Citizenship and Immigration Services (USCIS) approved educational evaluation service. Practical professional experience can count towards a degree, and in gross terms, frequently three years of increasingly responsible practical experience in the field of specialization may be considered to be comparable to one year of U.S. College. The actual petitioner for the H-1B visa is the prospective employer, and the prospective employee is called the beneficiary of the visa petition. This perspective of the USCIS underscores the serious responsibilities of the U.S. employer in the H-1B visa application process.

The H-1B visa is subject to certain annual quotas: 65,000 for holders of a Bachelor's Degree or its foreign equivalent, and 20,000 for holders of a Master's Degree or higher. In times past, this quota could get used up quite quickly. The fiscal year of the USCIS runs from October 1 until September 30, so the earlier in the agency's fiscal year that an H-1B petition can be filed, the better. An H-1B visa petition can be filed six months in advance so that many prospective employers file on April 1 (six months before October 1).

During a booming economy, the USCIS would be inundated by more petitions than H-1B visas were available under this quota system, resulting in a lottery to arbitrarily select 85,000 total from amongst the deluge of petitions received on or around April 1.

A few other interesting considerations about the H-1B should be noted. The U.S. Department of Homeland Security has increased its vigilance for employees on H-1B visas who work off-site at a different location than the employer's location specified in the visa petition. This situation has become particularly common in the IT industry where employees frequently engage in employment off-site. If there is a lack of direct supervision by and reporting to the employer, and if there has not been a prior U.S. Department of Labor approval of local wages in the off-site location for the position in question, the H-1B visa is vulnerable to being denied at the petition stage, or even being revoked if the H-1B visa holder has been granted a visa. Whether working off-site or not, the employee's prospective wage initially must be approved by the U.S. Department of Labor as part of the H-1B visa process.

The H-1B visa is normally valid for a total of six years, subject to limited extensions if the employer is far enough along in a green card petition process for its H-1B employee. One can apply from an H-1B for a green card, but this is not automatic. First, the U.S. Department of Labor must review an application for labor certification by the employer; demonstrating unsuccessful recruitment efforts for a qualified U.S. worker and agree that there is no one "minimally qualified" to fill the position for which the green card is being sought.

OPT – Frequent Precursor to the H-1B Visa

Many talented foreigners study in the U.S. as foreign students on an F-1 visa. They actually may be eligible to remain in the U.S. up to 29 months upon graduation without the employer having to apply for the H-1B visa. This gives an employer some flexibility to decide if it wants to sponsor the worker for an H-1B visa. Normally this so-called Optional Practical Training (OPT) period is notated by a school official on the back of a Form I-20 provided to the graduate, entitling the graduate to apply for an employment authorization document and work.

Normally the OPT is for 12 months, but if the graduate holds a degree in any of the so-called STEM subjects -- Sciences, Technology, Engineering or Mathematics -- the period of authorized stay as an OPT can be extended by another 17 months, totaling 29 months. At the expiration of this OPT period; the graduate must have either transferred to another employer-sponsored visa or leave the U.S.

For an employer to take advantage of the OPT period, it must enroll in the free, federal online employment verification service called E-Verify.

L-1 Visa

The L-1 visa is an interesting nonimmigrant visa for transferees from a foreign company that either effectively controls or is controlled by its U.S. affiliate where the transferee will be employed. Alternatively, both companies must be effectively controlled by a third company, such as a holding company. The individual must have worked at the foreign affiliate for at least one year within three years preceding the application to become an L visa holder.

There are two types of L visa: L-1A and L-1B. The L-1A visa is for an intra-company transfer of a manager or executive to the U.S. Company and is valid for up to seven years. The benefit of the L-1A visa is that it provides a fairly easy route to a green card.

The other type of L visa is the L-1B visa. This type of L visa is for an individual with specialized knowledge of a product or process of the two companies. It is valid for five years and, unlike the L-1A, does not permit pre-certification for a green card. This means that for a green card for its L-1B employee, the U.S. employer, like an H-1B employer desiring permanent U.S. residence for an employee, must go through recruitment efforts to hire a minimally qualified U.S. worker and be able to prove to the U.S. Department of Labor that its recruitment efforts were fruitless.

E-1 Treaty Trader and E-2 Treaty Investor Visas

Both of the above visas are treaty-based, meaning that the U.S. has entered into a bilateral treaty of commerce and navigation with the treaty country. Some countries have a treaty for either the E-1 treaty trader, or E-2 treaty investor visa; some have treaties for both. These treaty visas are only available to citizens of the country that signed the treaty and require that at least 50 percent of the ownership of the U.S. entity be owned by citizens of the same country.

The E-1 visa is intended for prospective foreign employees of the U.S. Company that is engaged in significant trade with the treaty country, either by import or export. The E-2 visa is available for executives, supervisors, those having essential skills, and the investors themselves to work for the U.S. Company whose source of investment derives from the treaty country.

The E-2 visa applicant must also have the same nationality as the source of investment. It is important that the investment in an E visa situation do more than just support the investor and his or her family.

The E visa is renewable indefinitely and carries with it nonimmigrant intent to remain permanently in the U.S. Based upon treaty and thus under the jurisdiction of the U.S. Department of State, the E visa application is not reviewed and approved by the USCIS but rather by the local Consulate or Embassy where the visa applicant lives.

O-1 Visa

Foreigners who enjoy sustained national or international acclaim may be eligible for the O-1 visa. This category is difficult, but not impossible, to obtain, subject to sufficiently convincing extrinsic evidence of the foreigner's reputation and career achievements. An O-1 visa is renewable indefinitely and is eligible for transfer to a green card.

Other Visas: F, J, E-3 and Derivative Family Employment

Foreign students enter the U.S. as F-1 visa holders and, upon graduation from a U.S. academic institutions may be eligible for the Optional Practical Training period discussed above.

Additionally, there is the J-1 visa which is actually approved by an entity that has received prior authorization to grant the visa by the U.S. Department of State. The duration of the J visa differs, as this visa can be used for researchers, scholars, interns and trainees. Business trainees usually only are entitled to an 18 month stay, and such a J visa is neither renewable nor extendable. Some J visa holders, such as medical graduates, may have a two year foreign residency requirement in their home country at the end of their permitted stay before being permitted to return to the U.S. This foreign residency requirement is capable of being waived under certain circumstances.

The E-3 visa is specific to Australian citizens who meet the requirements of an H-1B visa. It is processed entirely at a U.S. Consulate or Embassy and permits the E-3 visa holder and immediate family to live and work in the U.S. as long as the E-3 visa is valid. An E-3 visa is renewable indefinitely.

All nonimmigrant visas previously discussed permit spouses and children under the age of 21 to enter and live in the U.S. for the same duration as the visa beneficiary parent or spouse. Spouses of L-1A, L-1B, E-1, E-2, E-3 and J-1 visa holders may all obtain employment authorization based upon the primary visa holder's status.

Spouses and children of the other visa holders must be sponsored for a work visa, usually an H-1B, by their own prospective employer, although legislation is being considered to permit spouses of H-1B visa holders to work under certain circumstances.

Green Card

The green card is the coveted U.S. permanent residence visa which is a precursor to U.S. citizenship. This permits an individual, spouse and children to reside permanently in the U.S.

An individual can obtain a green card through two routes: family-sponsored, which is usually by marriage to a U.S. citizen, or through a U.S. employer petitioning on its employee's behalf. Employment-based green cards are subject to several conditions. Some green card petitions require a U.S. Department of Labor certification that the U.S. employer has unsuccessfully sought U.S. workers through a series of designated recruitment efforts.

Additionally, the number of green cards available is subject to an annual quota, broken down by preference based upon career achievement and/or education level, and further broken down by country of origin. The latter country-based quota entails that individuals from certain countries, such as India and China, face a longer wait than nationals of other countries from whence there is less demand for a U.S. green card. This backlog can extend many years and can present a challenge to both the employee and employer, requiring careful planning and timing. Some green card applications are excluded from such per country quotas if they fall into the first preference reserved for the L-1A intercompany executive or managerial transferee or if the green card applicant is of an outstanding nature, falling into the so-called first preference. The degree of acclaim and recognition for this first preference green card is somewhat higher than that of an O-1 visa holder.

Holders of a green card based on employment are eligible for U.S. citizenship after five years of permanent residence, subject to successful background checks.

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LABOR RELATIONS AND WORKING CONDITIONS

By William J. Austin, Jr., Ward and Smith, P.A.

Employment Contracts and the At Will Rule

The employer – employee relationship proceeds from contract law. Typically the employment contract is not in writing, and it may be comprised of no more than the employee's commitment to perform services for the employer in consideration of the employer's promise to pay compensation to the employee.

Seldom so simple, yet even the most comprehensive employment contract falls short of addressing each and every contingency the parties will face in the course of employment. We live in a regulated society to boot. The law then, whether judge made as in the common law or enacted by the legislative branch of government, imposes additional terms and conditions.

A first principle of employment law in the United States is still the At Will Rule. Originally a creature of 19th Century common law, it holds that the employment relationship is terminable at the will of either the employer or the employee in the absence of their mutual assent to a fixed term. In other words, if the parties do not agree that the employment is for a definite period of time, then either party may unilaterally end the relationship at will. Relentlessly applied, employers may hire and fire whomever, and whenever, they want.

The unmitigated At Will Rule gave employers enormous power, not only to terminate employees at will but also to impose other terms of employment. In the face of oppressive, even dangerous, working conditions the disgruntled employee's only legal recourse was to quit. That he could do so with legal impunity was cold comfort when a living had to be made and all employers had the same disproportionate power. No port in the storm, employees without mediation had to deal with employers' implicit power to dictate the program of work.

The At Will Rule was in full flower through the first quarter of the Twentieth Century in the U.S. To this day an integral feature of U.S. employment law, it has been increasingly encroached by a rising tide of regulatory restraint. Within the span of the last 80 - plus years, the employer's at-will and implied powers have been greatly curtailed by laws that prohibit discrimination and regulate other terms and conditions of employment. This area of the law is dynamic and must be closely watched.

U.S. Laws that Prohibit Discrimination

The following laws prohibit discrimination by employers on the basis of protected traits, characteristics or conditions:

- Title VII of the Civil Rights Act of 1964 (Title VII), 42 U.S.C. § 2000e, prohibits discrimination on the basis of race, color, religion, sex and national origin. Employers with at least 15 employees are covered as are agents of covered employers.
- The Age Discrimination in Employment Act of 1967 (ADEA), 29 U.S.C. §§ 621-634, protects individuals 40 years of age and older. Its coverage is nearly identical to Title VII, except for the minimum of 20 employees.
- The Equal Pay Act of 1963 (EPA), 29 U.S.C. § 206(d), prohibits wage disparity based on sex. Aptly said, "Equal pay for equal work."
- The Genetic Information Nondiscrimination Act of 2008 (GINA), 42 U.S.C. § 2000ff, covers employers with at least 15 employees and protects employees from discrimination on the basis of genetic information.
- The Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. §§ 12101-12113, protects individuals with disabilities. Employers with at least 15 employees are covered.
- The Rehabilitation Act of 1973, 29 U.S.C. § 790, et seq., offers parallel protection for federal employees and employees of entities receiving federal funds.
- The Civil Rights Act of 1866 (Section 1981), 42 U.S.C. §1981, provides protection from employment discrimination on the basis of race. Employers are covered regardless of the number of employees.
- The Pregnancy Discrimination Act, codified at 42 U.S.C. § 2000e (k), provides protection for pregnancy and related medical conditions. It makes disparate treatment based on pregnancy a type of discrimination "because of sex" and, therefore, illegal under Title VII.
- The Uniformed Services Employment Reemployment Rights Act of 1994 (U.S.ERRA), 38 U.S.C. § 4301, et seq., protects individuals who perform "service in the uniformed services" including National Guard duty. Employers are covered regardless of the number of employees.
- The Immigration Reform and Control Act of 1986 (IRCA), Pub. L. No. 99-603, 100 Stat. 3359 (1986), codified in scattered sections of Title 8 of the U.S. Code, contains protection against discrimination on the basis of citizenship-status and national origin. Employers with four or more employees are covered.

- Executive Order 11246 prohibits government contractors from discriminating on the basis of race, color, religion, sex and national origin, and also requires certain government contractors to develop affirmative action plans.

U.S. Laws that Regulate Other Terms and Conditions of Employment

These laws impose requirements on the parties' obligations and rights within the employment relationship:

- The Fair Labor Standards Act of 1938 (FLSA), 29 U.S.C. § 201, et seq., provides for minimum wage (currently $7.25 per hour) and time-and-a-half overtime pay for over forty hours of work per week. Section 15(a)(3) of the FLSA protects employees who suffer retaliation for filing wage and hour complaints. 29 U.S.C. § 215(a)(3)
- The Occupational Safety and Health Act of 1970 (OSHA Act), 42 U.S.C. §§ 651-678, provides for workplace safety and applies to nearly all private employers except industries regulated by other federal agencies (like mining, nuclear energy) and family farms. (A small employer exception, ten or fewer employees, applies to OSHA record-keeping requirements.)
- The Family and Medical Leave Act of 1993 (FMLA), 29 U.S.C. §§ 2601-2654, provides protected leave and reinstatement rights to eligible employees who have serious health conditions or family-related need to take time off. Private employers with at least 50 employees and all public agencies are covered.
- The National Labor Relations Act (NLRA), 29 U.S.C. §§ 151-169, protects the rights of employees to form and join labor organizations, to bargain collectively, and to engage in concerted activities for mutual aid and protection.
- The Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. §§ 2101 1209, provides some protection to employees involved in plant closures and mass layoffs. This law requires employers in those cases to give 60 days prior notice to the employees who will lose their jobs as well as to local government officials.
- The Fair Credit Reporting Act (FCRA), 15 U.S.C. §§ 1681-1681x, imposes duties on employers who use outside agencies to conduct background investigations on applicants for employment, including the obligation to notify an applicant of unfavorable information that may cause rejection.

State Laws

State laws typically mimic and double many of the federal laws listed above. In addition, workers' compensation is regulated on a state-by-state basis. Generally it provides wage replacement and medical benefits to employees who are injured or become ill in the course and scope of employment. Workers' compensation laws vary from state-to-state but a common element is the requirement that employers carry workers' compensation insurance or adequately self-insure to cover benefits payable to employees who are ill or injured due to workplace accidents and conditions.

Postscript: A Pending Bill in Congress

The Employment Non-Discrimination Act (ENDA) is the proposed federal legislation that would prohibit discrimination on the basis of sexual orientation and gender identity. Many state and local governments already prohibit sexual-orientation discrimination in the workplace.

ABOUT THE AUTHOR

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CHAPTER 5
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 complexity, client specific application and limited use, these regimes are not discussed in this general guide. Please contact us for further information.

CHAPTER 6
CORPORATE AND BUSINESS TAXES
(Income and Franchise)

U.S. Federal Tax Rate
A corporation organized in the U.S. is subject to federal corporate income tax on its worldwide 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.

A controlled group of corporations is limited to one set of tax rate brackets (i.e., please contact us for current tax brackets), and must share the use of such lower brackets among the members of the group (generally in any manner they formally elect). A controlled group of corporations may consist of a parent-subsidiary group, a brother-sister group, or a combined group of parent-subsidiary/brother-sister corporations.

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

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, film production, agriculture), 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 U.S. may qualify for the domestic manufacturing deduction.

Expensing Fixed Asset Additions

Generally, the cost of fixed assets (machinery and equipment, office furniture, buildings, etc.) must be capitalized and depreciated over prescribed recovery periods. However, certain “qualified” fixed asset additions can be expensed in the year acquired, subject to various limitations. These rules have been expanded and liberalized considerably over the past few years in response to the economic crises. A threshold amount of qualified fixed assets addition may be expensed in certain years (check with author for threshold for this year). This amount is reduced dollar-for-dollar by fixed asset additions in excess of a fixed amount each year (again, check with author on the fixed amount). In addition, the definition of qualified assets has been expanded to include certain leasehold improvements and other assets related to real estate, which have historically not been considered qualified fixed assets.

A 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.

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—and generally are paid to the IRS for the account of the owner at the highest rate of tax; 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 15th day of the 3rd month after the end of the tax year (i.e., March 15 for calendar year corporations). If the due date falls on a Saturday, Sunday or federal holiday, then 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 15th day of the 4th month after the end of the tax year (i.e., April 15 for calendar year partnerships and LLCs). 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 and corporate).

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 that are treated as partnerships) may request an automatic six-month extension to file its tax return. The IRS has shortened the extension period for partnerships (and domestic LLCs that are treated as partnerships) to five months. 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 non-extended 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 15th day of the 6th month after the end of the tax year (June 15 for a calendar year corporation). 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/require partnerships and LLCs to file a single “composite” income tax return on behalf of all the owners who are not residents of a particular state.

Payment and Collection

Corporate income tax is generally paid in advance, on a quarterly basis. 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 situations. Often, they are required to remit tax based on the entity’s earnings, not on actual distributions. These 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, since tax generally must be withheld. However, there are exceptions and exemptions that can be applied for by the knowing, tax compliant partner/member.

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 shares of the entity's profit or loss on a U.S. federal tax return. The taxes withheld as described above are credited against the liability computed on the return, and the partner or member pays any additional taxes due or receives a refund of any overpayment of taxes.

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 including certain city/local income taxes that can apply. Generally, each state computes taxable income differently, but most of them begin with federally 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 adding back the deduction for state taxes, the amount of federal depreciation in excess of the amount allowable for state purposes, federal 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. In recent years, however, several states have moved to a single sales-based apportionment factor.

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. In addition, some state legislatures have enacted gross receipts taxes which are assessed on the commercial activities (gross receipts) derived from such states.

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 of the affiliated group. 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 from losses generated.

Most states tax each corporation separately. Some states 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 worldwide profits including capital gains. A foreign tax credit mechanism, subject to various limitations, is available to alleviate the possibility of double taxation of income that is also taxed in a foreign jurisdiction.

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. Non-resident companies from a country which has a bilateral tax treaty with the U.S. and that conduct business in the U.S., but do not have a permanent establishment, are not subject to tax in the U.S. They are, however, still required to file a corporate income tax return and still may be subject to state and local taxes.

The branch profits tax generally applies to the branch's earnings (after income tax) that are deemed repatriated to the home office. In addition, a branch is required to withhold a fixed percent of the interest actually paid and deemed paid by the branch to the home office or a non-U.S. lender (contact author for current fixed rate). 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, including individuals and corporations, 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.

Multinational Corporations

In general, U.S. parent corporations are able to "defer" the earnings of their non-U.S. subsidiaries until these earnings are distributed as dividends to the U.S. parent.

However, the so-called "subpart F" rules require income taxes to be paid on a "deemed dividend" of earnings that have not yet been physically distributed to a U.S. parent in some cases. These rules, which have been a part of the U.S. tax system since 1962, are highly complex and are generally viewed as not in keeping with the ways in which multinational corporations operate.

Accordingly, when establishing a multinational corporation, strong consideration should be given to locating the parent company outside of the U.S. At the very least, the subpart F deemed dividend rules should be one of the many factors that are considered when a multinational structure is established that has U.S. operations.

Withholding Tax

Certain types of payments constituting U.S. source income made to non-residents are subject to U.S. withholding tax, and other types of payments may be tax exempt if paid to a foreign person. The non-treaty withholding rate 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, or to explain that no withholding is due because of the foreign status of the entity to be paid. This information is generally provided through the use of the W-8 series of forms. 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 withholding tax, unless modified or eliminated under a U.S. income tax treaty.

Royalties

A 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, unless modified or eliminated under a U.S. income tax treaty. 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 a withholding tax, unless they are for bank interest, qualify as portfolio debt or are modified or eliminated under a U.S. income tax treaty. See also the section entitled “Thin Capitalization.”

Losses

Generally, a tax loss (Net Operating Loss or NOL) must be carried back two years and then forward for 20 years to offset other taxable income. An election can be made to forgo the carry back and thus only carry forward an NOL.

In corporate acquisitions, the use of the acquired company's tax loss carryforwards and certain other favorable tax attributes are generally limited or forfeited.

Start-Up and Organizational Costs

A taxpayer may generally elect to deduct up to a fixed amount of start-up and of organizational expenditures in the taxable year in which the trade or business begins. However, each deduction is reduced (but not below zero) by the amount the cumulative cost of start-up or organizational expenditures exceeds.

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 raising capital are not deductible, but are included in the investor's basis and used to decrease the gain (or increase the loss) upon sale or liquidation of the entity.

CHAPTER 7
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. 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 (please contact us for current rates).

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

Note that currently 24 foreign countries have Social Security "Totalization" agreements with the U.S., which may reduce or eliminate the U.S. FICA tax and SECA tax (see below).

Totalization Agreements

The U.S. currently has International Social Security "Totalization" agreements with Australia, Austria, Belgium, Canada, the Czech Republic, Chile, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, and the United Kingdom.

The agreements generally provide, among other things, that one country, but not both, will impose its Social Security tax and ultimately provide the benefits, thereby eliminating double Social Security taxation on a worker's earnings and the need to coordinate benefits at a later date.

In order for an individual to be covered by a Totalization agreement, affirmative action is required. The agreements are neither automatic nor retroactive, and only cover wages earned after the appropriate taxing agency has issued a Certificate of Coverage.

CHAPTER 8
VAT / GST / SALES AND USE TAX

The U.S.' equivalent to VAT or GST 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. The rules vary by jurisdiction, and typically range from 5 to 8 percent.

Generally speaking, sales tax is imposed on the sale or purchase of tangible property and some services.

A business is responsible for collecting the sales or use tax on its 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, and controversy reigns over whether "physical presence" or a broader concept of "economic presence" will be used in the future to create liability and compliance exposure.

Once nexus is established, the business will need to determine if the product or service sold is subject to sales 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 tax should be charged as part of the transaction and remitted to the state.

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 use 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 mail, phone and Internet sales to customers where the seller does not otherwise have nexus. Additional information on the Agreement may be found at http://www.streamlinedsalestax.org.

On October 25, 2007, the United States Senate passed amendments to the Internet Tax Freedom Act Amendments Act of 2007 (Act). The amendments extend the moratorium on taxes on internet access and multiple and discriminatory taxes on electronic commerce imposed by the Internet Tax Freedom Act until November 1, 2014.

Businesses that are required to collect and remit sales tax (or pay use tax) do so by filing separate sales tax returns, which can be audited by state authorities, generally within three years. If no returns are filed, there is no statute of limitations for auditing and collecting past due taxes.

CHAPTER 9
SPECIAL INTEREST ISSUES

Transfer Pricing

The U.S., 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. Obtaining evidence supporting a pricing position in advance of filing a tax return can be expensive, but it also can prevent penalties that can often be as much as 40 percent of the understated tax plus interest from the original due date.

Controlled Foreign Corporation Taxation

As stated above, the general rule is that income of a foreign subsidiary of a U.S. parent is not taxable (i.e., it is “deferred”) until physically remitted to the U.S. However, 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, all or part of the gains on the sale of CFC shares can be recharacterized as dividend income.

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 four 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) 5 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 (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.

Investing in U.S. Real Estate

Investors in U.S. real estate (U.S. real property) encounter an alphabet soup of general and special purpose entities that can dramatically change how they are taxed and how much tax they will pay if their investment meets with success — and sometimes regardless of results. LLC (Limited Liability Company), LP (or GP, for limited and general partnership), Inc. (or sometimes "Corp" for corporation); and REIT (Real Estate Investment Trust) are only a few of the popular monikers to go along with RIC, REMIC, UP-REITS and countless variations on the theme for real estate and related investing.

The choice of entity, or a special purpose entity interposed between the foreign investor and the U.S. real estate, is situation specific. If real estate is about location, location, location, then planning to own it in the U.S. is structure, structure, structure.

The structure depends on factors such as the type of foreign investor (individual, corporation, trust, syndicate, etc.), the nature of the investment (e.g., long-term hold, net lease, development to sell, etc.), financing, the tax status of the investor, and whether widely held public companies or simply private investors are involved. Projections and plans are essential, since conflicting structures often produce marginally or significantly better results based on the outcome. The flexibility of the U.S. tax and entity system makes the best structure a fact driven decision. One thing that is virtually certain, however, is that a tax will be due when the property is sold to a third party at a profit due to special anti-avoidance legislation for real estate. The rules from the Foreign Investment in Real Property Tax Act (FIRPTA) apply to all real property and its derivative forms, including mineral interests, most leaseholds and companies that own the property. The tax can be deferred but sooner or later it will be due. Like most countries, the U.S. also has special rules that both favor and manage tax avoidance in connection with foreign investment in real estate. Two are worth highlighting.

Gains from real estate can be rolled over through “like-kind exchanges,” which are also known by the Code section 1031 that permits them. The process is regimented and investors must follow strict rules to never receive the cash on a sale. This is typically accomplished by using a qualified intermediary (title companies, trust companies, banks or other special purpose entities that are in the business of accommodating like-kind exchanges) on any sale that precedes a purchase. Cash received is taxed currently when sale proceeds are not fully reinvested through the intermediary. Strict timing and adherence to statutory form is essential for identifying properties that are being acquired within 45 days in exchange for properties that are being sold, and the exchange must be complete within 180 days or the sale is taxable. Nevertheless, through this technique, successful investments in U.S. real estate can be rolled forward into virtual perpetuity. In some cases, the cash flow from operations and refinancing can be enjoyed tax free for a very long time.

In the anti-avoidance area, in addition to FIRPTA, the U.S. has strict anti-earnings stripping rules that apply to all but totally independent debt financing. It has been said that even if a foreign-related person winks at the domestic U.S. lender to provide any form of assurance of repayment, interest on the debt is only deductible to the extent of half the adjusted taxable income of the U.S. taxpayer.

In spite of, or perhaps because of, the current economic difficulties, the U.S. is reported to have significant attractive real estate investment opportunities for foreigners. These investments appear particularly cheap to some at today’s exchange rates. There is a desirable structure to optimize any of these property investment opportunities.

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 Account Reporting

Each U.S. person who has a financial interest in 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 FinCEN Form 114 "Report of Foreign Bank and Financial Accounts" and must be filed annually if, at any point during the calendar year, a U.S. person has such ownership. It must be filed electronically effective July 1, 2013. Form 114 ("FBAR") is due by June 30 of the year following the date the requirements are met.

Failure to file the FBAR could result in civil and criminal penalties.

Any U.S. person who has interests in or, authority over, foreign financial accounts with a combined value of more than $10,000 must file the FBAR. This includes all U.S. citizens and resident aliens, and all U.S. estates, trusts, partnerships and corporations.

The income tax "substantial presence" test may cause an individual to be required to file the FBAR. This test provides that an individual becomes a U.S. tax resident (regardless of immigration status) if he or she is present in the U.S. during the current tax year for at least 31 days and for a total of 183 or more weighted average days over a three-year period that includes the two preceding calendar years. The weighted average is calculated by counting one day for each day in the current year, 1/3 of a day for the previous year and 1/6 of a day in the second preceding year. Days of arrival and departure are counted as full days, no matter how brief the presence.

Any type of account that holds liquid assets or marketable securities meets the definition of "financial account" for reporting purposes. This includes everything from a cash account to a foreign mutual fund and certain foreign pension and insurance policies.

The ability to order the distribution or disbursement of funds by signing a document providing such direction qualifies the individual as having "signature authority" over the account. Individuals who can make investment decisions but who do not have the ability or discretion to make disbursements do not have a FBAR reporting requirement.

For example, a Director who does not operate or solely control management should not be required to file a form for an account on which he or she was not a signatory. In addition, an individual has a financial interest in every account for which the individual is the owner of record or has legal title.

As mentioned above, a taxpayer is required to file Form 114 with the U.S. Department of the Treasury by June 30 of the year following the calendar year in which the taxpayer meets the $10,000 filing requirement.

Congress enacted an additional filing requirement effective for tax years beginning after March 18, 2010. The Foreign Account Tax Compliance Act (FATCA) requires individuals who hold any interest in foreign financial assets, as specified under the Internal Revenue Code, to complete and attach Form 8938 to their annual income tax return. The threshold is higher for individuals who live outside the U.S. and the thresholds are different for married and single taxpayers.

The FATCA rules are relatively new and are still developing. However, one thing is fairly certain. The new reporting requirements serve a different government purpose from the FBAR filing requirements. The definitions and specific reporting requirements differ between the two sets of rules.

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 the 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." There are special rules, discussed above, for companies that principally own U.S. real estate.

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. Dividends are not tax deductible by the payer. 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.

While the form of the transaction executed by the taxpayer will typically prevail, U.S. tax law in this area provides broad authority for the IRS to re-cast a structure based on its economic substance over its self-serving form. Thus, in order to determine the federal tax implications, the substance of an obligation must be carefully evaluated in the planning stage 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 “anti-earnings stripping” provision applies when the U.S. Corporation realizes tax losses or insufficient amounts of taxable income prior to all interest charges, depreciation and certain other adjustments, if the U.S. Corporation’s debt-to-equity ratio exceeds a prescribed ratio. 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 a 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 does 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.

Some of these incentives are 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. Other recently emerging state and local incentives include “green programs” to promote energy efficient construction and renewable energy projects.

Worker Classification

The proper classification of a worker as an employee or an independent contractor can have significant effects on a business and its workers. The determination of the proper classification of workers is a “facts and circumstances” test that has been the subject of much controversy and litigation. A worker is generally considered an employee when the employer has the right to control and direct the individual who performs the work. Control seems to be the largest factor for distinguishing between the two classifications.

The abundant case law has created six areas the Internal Revenue Service focuses on when determining whether an individual is an employee or an independent contractor:

1. Details of the work performance
2. Expenses of the work performance
3. Compensation for the work performance
4. Duration of the work position
5. Structure of the work position
6. Location of the work performance

Even with all of this history, the answer is often far from clear and is based on the unique facts and circumstances in each case.

CHAPTER 10
PERSONAL INCOME TAXATION

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. The U.S. tax law with respect to the taxation of foreign individuals is complex, and a competent tax advisor should be engaged to ensure full compliance with the tax laws.

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 U.S. 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 and the personal use of employer-owned automobiles.

   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 any 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 underpayment 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:

- Federal Income Tax
- Resident State Income Tax
- Work/office State's Income Tax, if different from the employee's resident state
- 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.

   - FICA tax, which is for the U.S. retirement system, generally referred to as Social Security tax, is charged at 5.2 percent of first $110,100 for 2012, adjusted annually.
   - Medicare tax, which provides health care for elderly persons, disabled workers, and certain survivors (children and spouses) of wage earners, is charged at 1.45 percent 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.

   There are thousands of systems and definitions in use by each U.S. state and locality 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:

1. Real property construction or improvement is generally not subject to sales/use tax on the end consumer. 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.

2. Purchases made outside of the purchaser's home state are generally subject to use tax in the home state if the out-of-state vendor does not collect the taxes at the point of sale. Examples: (1) 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) New York resident purchases clothing from a store while on vacation in Las Vegas, Nevada; (3) 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 section 1) 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 provide local services, such as schools, sanitation, fire and police.

   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. In such instances, 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 (e.g., 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 coexist in the U.S.

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.

General Rules of Individual Income Taxation

The U.S. imposes a maximum individual income tax rate on ordinary income. Taxable income of a single individual—excluding net long-term capital gains—is subject to federal individual income tax at graduated rates (contact author for current rates).

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.”

Lower rates apply to long-term capital gains (assets held more than one year), which are generally taxed at a fixed percent. Currently, “qualified” dividends are also subject to a maximum fixed percent rate. There is a special capital gains rate for depreciation recapture on the sale of real estate.

An Alternative Minimum Tax applies if a substantial amount of an individual’s deductions or income excluded from current taxation is related to “preference items,” such as the 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.

State income taxes, if applicable, are in addition to the above federal income tax amounts (see below). The U.S. taxes its citizens and permanent residents (i.e., “green card” holders) on their worldwide 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 worldwide 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. if the income earned each year is over a specific amount (contact author for current figure), 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. Tax treaties with an individual's home country often reduce the exposure and complexity, but they must be considered for each particular set of facts. 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 and allows for a filing date of October 15. If the due date falls on a Saturday, Sunday or federal holiday, then the due date becomes the next business day.

Individuals are also generally required to make estimated tax payments during the year as income is earned, especially if the income is not subject to withholding or likely to be under-withheld at source. An employer is required to withhold on wages, and this withholding often satisfies the tax liability associated with the wages unless an employee receives large lump sums, such as bonuses.
Since U.S. tax is based on aggregated results of all activity, estimates may be required. Estimated payments are due generally in 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, or in some cases based on the total tax owed in the prior year.

State and local income taxes vary by location. Some states replace income tax with wealth taxes, 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.

CHAPTER 11
ESTATE AND GIFT TAXES

The estate and gift tax is not an income tax, but rather a wealth transfer tax. The transfer tax regime 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 gain from the property's appreciation in the event of a future sale.

Estate Tax

The federal estate tax was reinstated for 2011 and future years. 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 U.S. Domicile is defined as the place where the individual resides with an intention to remain indefinitely. A tax imposed upon long standing resident aliens who permanently leave the U.S. has recently been enacted and should be reviewed. The tax impact of the resident's state and states in which taxable property resides should be reviewed.

U.S. citizens and U.S.-domiciled foreign citizens are taxed at death on the fair market value of all of the decedent's worldwide 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. Otherwise, U.S. estate tax generally applies to any U.S. estate of $60,000 or more.

Only certain property situated in the U.S. owned by a foreign citizen not domiciled in the U.S. at the time of death—and not a U.S. citizen—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 countries.

Gift Tax

U.S. citizens and U.S.-domiciled foreign citizens are subject to gift tax on the fair market value of all gifts made during a lifetime unless 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. For gifts made after Dec. 31, 2010, the gift tax is reunified with the estate tax.

An individual can also make multiple gifts of a fixed amount in a year 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). This exclusion amount is indexed for inflation each year and does not need to be reported.

Gifts made by foreign citizens who are not domiciled 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. tangible property, including cash, U.S. stocks (i.e., shares) and bonds, are generally not subject to U.S. tax, as long as the gift is not made in the U.S.

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.

Gifts of less than an amount which is adjusted annually for inflation, received by U.S. citizens and U.S. residents (as defined under the income tax regime) from foreign citizens are not taxable in the U.S.

However, aggregate gifts over the annual amount received during a calendar year must be reported to the Internal Revenue Service on Form 3520 (Check with author for annual tax tables).

When a donor does not pay gift tax, the receiver may have “transference liability” in some cases. Failure to report gifts can be subject to a penalty of a 5 percent of the gift for each month, up to a maximum of 25 percent.

Future Legislation

The U.S. estate and gift tax regime has been under scrutiny for several years now. Thus it is particularly important to monitor actual and proposed legislative activity in this area.

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NOTES

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- How to benefit from an IC-DISC, the congressionally mandated program designed to give tax breaks to U.S. exporters
- The business and non-tax benefits that a transfer pricing study can provide to you and your business
- The similarities between international tax and multi-state tax (and their differences)

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