

Market Entry: United States

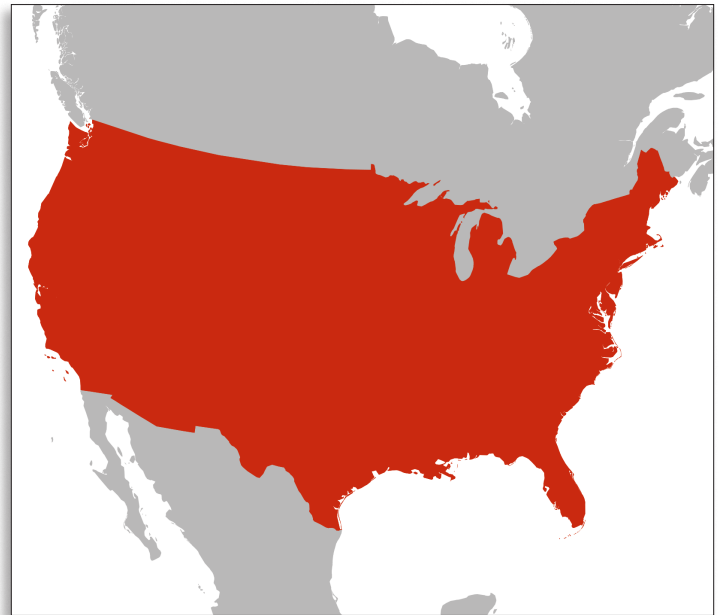
ABOUT PILLSBURY

Pillsbury Winthrop Shaw Pittman LLP is a leading international law firm with 15 offices in North America, Asia and Europe. The firm is more than 140 years old and represents most of the Fortune 100 companies in the U.S. as well as hundreds of emerging growth and high technology companies. Our China Practice represents many PRC companies and investors making acquisitions, establishing operations and investing in companies located in the U.S. Our bilingual and multicultural attorneys in Shanghai, Beijing, San Francisco, Silicon Valley, and throughout the United States provide efficient, understandable support for Chinese businesses doing business with and in the United States.

BUSINESS OBJECTIVES

Entry into the U.S. market starts with a clear statement of a client's business objective. The best structure for a client, as well as the possible regulatory issues, depend on what the client wants to do. For example,

- **Sales office.** Establishing a sales office is relatively simple. In fact, it may not even be necessary to form a U.S. legal entity, although doing so will simplify many issues, including tax and employment.
- **Research and development (R&D) center.** Establishing an R&D center in the U.S. is also relatively simple. The key issues will revolve around immigration, employment, intellectual property (IP) and, depending on the technology, national security implications.
- **Manufacturing.** Establishing manufacturing operations can be more complicated, and usually involves real estate, local tax and other subsidies and incentives, more extensive labor and employment questions, IP, environmental, and other issues.
- **M&A.** Many Chinese investors enter the U.S. market through the acquisition of a U.S. business. This can usually be done without government approvals, but the process is more intensive from a legal/transactional point of view than in China.



- **Joint ventures.** Joint ventures are not as common in the U.S. as in China. However, minority and even majority investments in U.S. companies are very common, and these types of investments are effectively joint ventures.

TYPES OF ENTITIES

There are three principal types of legal entities in the United States:

- **Corporations.** A corporation is a separate legal entity with limited liability. It is designated with "Inc." (for "incorporated"), "Corp.," or "Company" in the corporate name. The same corporate form is used for private companies and public companies; the U.S. does not have the concept of "companies limited by shares." Corporations can own other corporations; there is no separate "holding company" form of entity in the U.S. Corporations are taxable entities, just as in China.

Market Entry

- **LLCs.** Most states now permit the formation of “limited liability companies” or “LLCs.” An LLC is a separate legal entity with limited liability, but it is not separately taxed. Instead, its income is attributed to its members (owners) who are taxed on that income.
- **Partnerships.** Partnerships are separate legal entities. They may have both general and limited partners. The equity interests are called “partnership interests.” The general partners are liable for all the obligations of the partnership, but the liability of limited partners is limited to their investments. Partnerships are not separately taxed.

There are other types of entities used for special purposes, such as professional corporations and financial institutions. Most Chinese investors use the corporate form for their U.S. operations.

DIFFERENCES WITH CHINA

There are a number of differences between China and the U.S. with regard to corporate formation:

- **National versus state.** In the U.S., every state has its own company law. There is no national company law as there is in China. A company may be organized under the laws of one state but carry on business in other states. The owners of the new company can freely choose the state of organization for their company; many owners choose Delaware because its laws are well organized and the state officials operate with high efficiency.
- **State versus local.** Corporations are chartered by the states, not cities or districts within states. The government office in each state which is in charge of corporations is in the state capital.
- **Registered capital.** We do not have the concept of “registered capital” in the United States. There is no minimum capitalization set by government regulation. Each corporation should be capitalized to a level sufficient to meet its needs.
- **Shareholders.** Corporations may have a single shareholder or many shareholders. There is no citizenship or nationality requirement for shareholders.
- **Share ownership.** In China, the ownership interests of the equity holders of private companies are determined by their relative contributions to capital. In the United States the allocation of ownership is entirely within the control of the shareholders and is not required to be related to their relative contributions.

- **Classes of shares.** In China there is only one type of equity in a private company. In the United States companies may create as many different classes, or series, of stock as they wish, each with different rights with regard to economic benefits, voting or control.
- **Boards of Directors.** Corporations must have at least one director. There are no citizenship or nationality requirements for directors. Directors may also be officers of the corporation.
- **Officers.** Most states require corporations to have at least a president and a secretary. In some states the same person cannot fill both offices.
- **Limited liability.** As in China, the liability of the shareholders of a company is limited to their investment, unless the shareholders disregard the corporate form.
- **Foreign-owned companies.** Foreign-owned companies are subject to the same law as domestic companies.

ENTITY FORMATION

Forming a corporation in the U.S. can take from a few days to a few weeks, depending on the state selected by the investors. We prepare all the paperwork and it is not required for the investors/shareholders to be physically present in the United States to complete the formation process.

There is no mandatory approval process for foreign investment in the United States. There is a national security-related voluntary reporting and review process, called “CFIUS” in the case of acquisitions (see below), which is similar to the system now in place in China.

We handle the entire process of corporate formation for our clients. This process typically includes:

- Certificate of incorporation
- Bylaws
- Stock purchase or subscription agreement(s) for injection of capital
- Issuance of stock certificates
- Organizational minutes of stockholders and board of directors
- Stock option plan

When the corporation is formed, the state government confirms the filing and acceptance of the certificate of incorporation. This is the definitive evidence of the company’s organization, not its business license. Once the entity is formed, we provide full corporate secretarial support.

M&A

Many Chinese investors enter the U.S. market through the acquisition of a business in this country. We handle all aspects of inbound M&A for our clients.

There is no mandatory foreign investment review and approval process for M&A in China. However, there is a voluntary reporting and review process carried out by the Committee on Foreign Investment in the United States (CFIUS), which in recent years has taken a particular interest in any investments by Chinese buyers. Parties to a transaction may voluntarily submit their deal to CFIUS for review. If CFIUS decides to review the transaction, it can require changes to be made in the structure of the deal. It is very rare for CFIUS to involve itself in the valuation of the deal.

Under the legal system in the U.S., unlike in China, most of the rights and obligations of parties to an M&A transaction must be specifically negotiated and included in the transaction documents. This makes those documents longer and more complicated than in the PRC. It is very important to engage legal and accounting/tax advisors early in the process.

The parties are free to choose the type of consideration to be used for the acquisition—cash, stock, tangible or intangible property, or even services. There is no requirement that the purchase price be paid within any specific period of time.

INTELLECTUAL PROPERTY

Preserving intellectual property is as important in the U.S. as in China. We take a comprehensive approach to the problem. We start by helping develop a comprehensive IP and brand protection strategy, including business policies and processes, location of sensitive IP and segregation of proprietary information, confidentiality and non-disclosure agreements, licensing, and registration of patents and trademarks. Working with PRC patent and trademark agents, we can then file and maintain a worldwide intellectual property portfolio.

REAL ESTATE

Most real estate in the U.S. is privately owned and can be freely transferred. Ownership of real estate is a matter of public record and title insurance is routinely available. Zoning restrictions impact the use to which any given parcel of real estate can be put.

TAXATION

The U.S. has a complex system of taxation at the national, state and local levels. The nominal tax rates tend to be high, but the effective rates of tax paid by most corporations tend to be lower, thanks to an extensive system of deductions and credits.

Unlike China, the U.S. has a system of “double taxation:” that is, corporate profits are taxed to the corporation, and any distribution of after-tax profits is taxed to the recipient as well.

REPATRIATION OF PROFITS

Profits may be freely repatriated to foreign shareholders after payment of a withholding tax. There are no foreign exchange controls.

SECURITIES LAWS

The U.S. has a complex regulatory regime applicable to the sale of securities to the public. The activities of most Chinese investors do not implicate these regulations, but if the client intends to raise money in the U.S., securities laws must be strictly complied with.

EMPLOYMENT LAWS

In most states employment is “at will,” meaning that no mandatory severance payments apply to terminations. However, the U.S. has a well-developed body of law dealing with employment practices and the rights of employees, which must be taken into account when hiring, disciplining, promoting and terminating any employees.

LITIGATION

The U.S. is known for its litigation. Most companies regard litigation as part of the anticipated business landscape. Careful attention to contracts, legal requirements applicable to operations, and employment practices can reduce the risks of litigation.

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This outline does not constitute legal advice. The legal consequences of any given transaction or situation must be examined on its individual facts. You should consult counsel before engaging in any transaction of a type contemplated in this outline.

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Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171
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