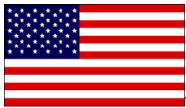
Fall | 23

INTERNATIONAL LAWYERS NETWORK

CONNOLLY GALLAGHER LLP,
DAVIS MALM & D'AGOSTINE P.C. &
LEWIS RICE LLC

ESTABLISHING A BUSINESS ENTITY IN THE UNITED STATES

ILN CORPORATE GROUP



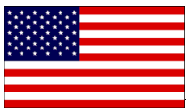
This guide offers an overview of legal aspects of establishing an entity and conducting business in the requisite jurisdictions. It is meant as an introduction to these market places and does not offer specific legal advice. This information is not intended to create, and receipt of it does not constitute, an attorney-client relationship, or its equivalent in the requisite jurisdiction.

Neither the International Lawyers Network or its employees, nor any of the contributing law firms or their partners or employees accepts any liability for anything contained in this guide or to any reader who relies on its content. Before concrete actions or decisions are taken, the reader should seek specific legal advice. The contributing member firms of the International Lawyers Network can advise in relation to questions regarding this guide in their respective jurisdictions and look forward to assisting. Please do not, however, share any confidential information with a member firm without first contacting that firm.

This guide describes the law in force in the requisite jurisdictions at the dates of preparation. This may be some time ago and the reader should bear in mind that statutes, regulations and rules are subject to change. No duty to update information is assumed by the ILN, its member firms, or the authors of this guide.

The information in this guide may be considered legal advertising.

Each contributing law firm is the owner of the copyright in its contribution. All rights reserved.



ESTABLISHING A BUSINESS ENTITY IN THE UNITED STATES

1. Choosing the Right Legal Structure

1.1 Introduction

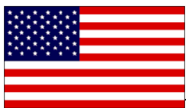
Establishing a business entity in the United States can be an important strategic step for any international company that wants to avail itself of the world's economy. There are, however, many considerations to weigh carefully in consultation with an experienced attorney. Perhaps first and foremost, a company should choose the legal structure that is most advantageous and best suited to their needs. Section 1 examines the basic principles of five of the most common types of business entities in the United States: the corporation, the limited liability company, the general partnership, the limited partnership, and the limited liability partnership. In particular, this Section will highlight governance, capitalization, personal liability, and tax treatment for each entity type. While the tax discussion will focus on federal income tax, most state laws follow federal income tax principles. Finally, some consideration will be given to less-common business structures and other regulatory issues.

1.2 A Preliminary Note: Choosing a State for Organizing the Entity

In the U.S. federal system, each state promulgates its own statutes and regulations that govern the business entities which may be established in that jurisdiction. It is important to remember that in most cases there is no general "U.S. corporation," and that choosing the state in which to organize is a preliminary decision that will affect a company's formation requirements and operations. A natural choice for local companies is often the state where the company maintains its primary place of business or U.S. headquarters. Nevertheless, a company domiciled in the U.S. can be organized in any state and Delaware is the most popular state for domestic and international companies alike. Delaware's Court of Chancery has extensive experience interpreting business legal documents and adjudicating disputes, and all cases are decided by judges. This lends a certain predictability that many businesses find desirable. In addition, the comparative speed at which the Delaware courts resolve those disputes is an attractive feature to many, and the Delaware Rapid Arbitration Act enacted in 2015 allows for even quicker resolution of disputes to those who choose that route. Many other states, however, are popular for a variety of reasons: New York, Maryland, and Nevada, to name a few. This article will provide general principles but will focus on Delaware law when referring to specific state laws or interpretations of state laws. Regardless of a company's chosen state, it may have to register as a "foreign" company in other states where it conducts business, may be subject to special fees or franchise taxes in those states, and may, in certain cases, be subject to restrictions imposed by local corporate statutes even though it is formed in Delaware.

1.3 The Corporation

The corporation has traditionally been the most popular form of business entity in the United States. Once formed under state law, corporations are often described as being "public" or "private," depending upon whether their shares are registered with the United States Securities and Exchange Commission and therefore freely tradable by members of the public or whether, instead, each individual trade of shares must be separately registered or fit within an exemption from applicable federal registration requirements. Generally, a private corporation may go public after establishing itself in the U.S. marketplace through an initial public offering ("IPO"), which is commonly undertaken to provide access to capital markets.



Governance: A corporation is owned by its stockholders, each of whom holds a certain number of shares representing equity ownership in the company. Management, however, is vested in a board of directors. In Delaware, a corporation may have any number of directors. The directors are not required to be United States citizens or residents. These directors owe important fiduciary duties to the corporation and its stockholders (and to creditors in an insolvency setting) and establish corporate by-laws to regulate corporate decision-making. Typically, the directors will delegate many of the day-to-day management activities to the officers of the corporation, subject to their oversight. Most corporations have at least three officers: a President (often also called the Chief Executive Officer), a Treasurer, and a Secretary, but many other officers are also often named by the Board. One person can serve in multiple roles as an officer, and a person may be both a director and officer. Officers also owe fiduciary duties and also need not be United States citizens or residents.

The fiduciary duties owed by directors and officers consist primarily of the duty of care and the duty of loyalty. The duty of care requires that the responsibilities of office be discharged in an informed and considered manner. The duty of loyalty requires that the relevant decision makers act on an independent and disinterested basis, in good faith, and in a manner that they honestly believe to be in the best interests of the corporation and its stockholders. Unless successfully rebutted by evidence of breaches of fiduciary duties, the business judgment rule will normally apply, and a Delaware court will not substitute its judgment for that of the board of directors or officers.

Stockholders are entitled to vote to elect the board of directors, to approve changes to the corporation's "charter" or certificate of incorporation (the terms are used interchangeably), and to vote on major corporate events including a merger, a sale of all or substantially all of the corporation's assets, or the dissolution of the corporation. Controlling stockholders owe fiduciary duties to minority stockholders.

In a close corporation (a statutorily defined type of corporation whose charter contains certain restrictions on the transfer and ownership of its shares), Delaware law allows direct management by the stockholders, so long as the corporation meets the statutory requirements for close corporation status. With the advent of the LLC (discussed later), which more readily permits management by members, close corporations are pretty rare today.

Capitalization: A corporation will generally issue shares of common stock to its founders upon formation. Either common or preferred stock, described more fully below, may be issued to investors to raise capital. A private corporation may pay out dividends to attract stockholders, since there is no readily available market for its shares; although under Delaware law the amount of the dividend must be less than the difference between the net assets of the corporation and the aggregate par value of its outstanding stock. It may also make "capital calls" (if permitted under its organizational documents or under a stockholder agreement) or issue additional shares (but not more than the number authorized in its charter) to raise capital. Public corporations can raise large amounts of capital via an IPO or additional public securities offerings. Dividends become less important to attract investors, because stockholders can freely trade their shares in the markets where they are listed.

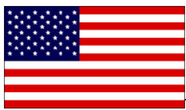
Corporations may, if authorized in their certificate of incorporation, issue additional classes of stock, usually called preferred stock, that give holders additional rights – such as priority for dividends or preference in a

liquidation – and may also restrict certain other rights, such as voting. Many private corporations also, or alternatively, elect to place transfer and ownership restrictions on their shares in a separate stockholders' agreement. Corporations may also raise capital by taking on debt. Many public corporations issue bonds to investors in addition to other traditional means of borrowing, while private corporations often issue preferred stock, sometimes in combination with traditional lending arrangements.

Personal liability: One very attractive aspect of a corporation is the limited liability of the stockholders. Generally, stockholders are exposed to liability only up to the amount of their investment in the corporation. Directors can potentially be personally liable to the stockholders for violations of certain fiduciary duties, but a corporation may include in its certificate of incorporation a provision that eliminates or limits the personal liability of directors for monetary damages for breaches of the duty of care. Moreover, many corporations carry directors and officers (D&O) liability insurance covering certain actions taken by directors and officers and will also indemnify their directors and officers for certain non-fraudulent behavior. If a private corporation is merely an alter-ego of a single owner, courts may "pierce the corporate veil" and hold that individual liable for the corporation's debts and obligations.

Tax treatment: U.S. domestic corporations generally are subject to U.S. federal income tax on their worldwide income regardless of source, but generally may claim a foreign tax credit or deduction for taxes imposed by non-U.S. jurisdictions. The U.S. also has detailed controlled foreign corporation rules under which income earned through foreign subsidiaries may be taxed. In addition, legislation enacted in 2017 has made a number of changes to the U.S. federal income tax rules applicable to U.S. domestic corporations to move the U.S. towards a modified territorial system of taxation. To accomplish this, U.S. domestic corporations are entitled to claim a deduction equal to the foreign source portion of any dividend received from certain 10% owned foreign corporations. For this purpose, a U.S. corporation is considered domestic if it is formed under U.S. law or the law of any U.S. state. Thus, a corporation organized under state law will be treated as domestic, and subject to tax on its worldwide income, regardless of whether its place of management and control is outside the U.S. One potential drawback to a corporation is that it is subject to so-called "double taxation." A U.S. corporation will pay state and federal corporate income tax on its income at the corporate level. Moreover, individual stockholders will also pay personal state and federal income tax on any income from dividends distributed. For tax years beginning after December 31, 2017, however, the U.S. federal corporate income tax rate is reduced from a top rate of 35% to 21%, significantly reducing the impact of corporate double taxation.

On August 16, 2022, the U.S. adopted the Inflation Reduction Act of 2022, which, in addition to other tax and spending measures, imposes a new 15% corporate minimum tax on the adjusted financial statement income of certain large corporations. This new tax is effective for tax years beginning after December 31, 2022. A corporation (other than an S-corporation, regulated investment company or real estate investment trust) will be subject to this minimum tax for a particular tax year if the average annual adjusted financial statement income for the three-tax-year period ending with such tax year exceeds $1 billion. A special rule will apply to members of a foreign-parented multinational group, under which the average annual adjusted financial statement income for



a corporation has to equal or exceed $100 million, if the adjusted financial statement income of all members of the group (as adjusted) exceeds $1 billion.

Some corporations, if they meet the qualifications, will opt for "S-corporation" filing status (a term referring to an election to be treated as an S-corporation under federal and state tax law, although certain states (e.g., New Jersey and New York) require a separate election to be taxed as an S-corporation at the state level). All profits (and losses) "pass through" an S-corporation and individual stockholders pay tax only at the personal income level, so long as the corporation maintains its S-corporation status. To maintain such status, there can be no more than 1 class of stock (with limited exceptions) and no more than 100 stockholders, and all stockholders must be U.S. citizens and natural persons, or certain qualified trusts. S-corporations are rarely useful in the international context.

1.4 The General Partnership

A general partnership is any association of two or more individuals or business entities who carry on a business for profit. The general partnership can be a very flexible structure, easily tailored to the needs of the partners via a partnership agreement. Moreover, general partnerships enjoy partnership taxation and are not taxed at the entity level. It is important, however, to consider some of the drawbacks of the general partnership before pursuing this type of entity.

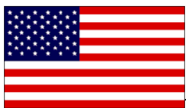
Governance: A general partnership is owned and controlled by the partners, who have wide latitude to organize partnership governance in the partnership agreement. In Delaware, for example, a partnership agreement will control in almost every situation unless the agreement conflicts with explicit statutory requirements. For large partnerships, these agreements can become very complex and will occasionally result in gridlock between partners. In general, a partner is an agent of the partnership, and owes the partnership basic fiduciary duties of care and loyalty. If any partner disassociates from the partnership, the partnership will automatically dissolve unless the partnership votes to continue business.

Capitalization: A partnership raises capital through equity contributions by the partners and by taking on debt. Partners may also be able to transfer their economic interest in the partnership to an outside party, such as a creditor, but with few exceptions partnership interests are not publicly traded in capital markets.

Personal liability: The major drawback to a general partnership is that each partner is jointly and severally liable for the obligations of the partnership. The only exception to this rule is if a partner joins a partnership after the obligation was incurred by the partnership.

Tax treatment: The partnership generally pays no income tax as an entity (the partnership may be liable for income tax liabilities asserted on audit, however). Instead, partners pay individual income tax on their distributive shares of partnership income (regardless of whether such income is distributed). This is known as "pass-through" taxation and is one of the most desirable aspects of forming a partnership.

Partnerships are typically taxed at the state level in the same way as they are taxed at the federal level – income, loss and tax liability flows through to the owners. Following the Tax Cuts and Jobs Act of 2017, individual taxpayers may only claim a federal deduction of up to $10,000 for all state level taxes paid. In response to this limitation, an increasing number of states have passed legislation that allows tax partnerships (and other pass-through entities, including S-corporations) to elect to pay tax at the entity



level rather than passing on the full liability to the owners, with a state tax credit to the individual owners for taxes paid by the partnership. The partnership, which is not subject to the limitation on state and local tax deductions, can claim a business expense deduction, and the individual owners can claim deductions for up to $10,000 for other state taxes paid, such as property taxes.

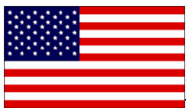
However, in the international context pass-through taxation is often a distinct problem because non-United States partners will be required to file United States tax returns and pay taxes to the United States. To provide for the collection of this tax, the partnership may be required to pay withholding tax on income of the partnership allocable to a foreign partner if such income is effectively connected with a U.S. trade or business. Amounts withheld can be claimed as a credit against a foreign partner's U.S. income tax liability. In addition, foreign corporations that invest in a partnership may be subject to a 30% branch profits tax on their accumulated earnings and profits effectively connected to a U.S. trade or business carried on by the partnership. For this reason, non-United States investors in partnerships (as well as LLCs, discussed below) often hold their interests through "blocker" companies formed in U.S. domestic or offshore jurisdictions. This permits these investors to obtain the benefits of pass-through taxation without subjecting the foreign investor to United States filing, tax and audit requirements that may reach all of their worldwide activities.

1.5 The Limited Liability Company ("LLC")

The LLC is a relatively new and increasingly popular choice of business entity. Nowadays, a substantial majority of new entities formed in Delaware are LLCs. Members of the LLC benefit from limited liability, pass-through taxation, and a highly customizable management framework. Nevertheless, because LLCs are relatively new (having first been introduced in 1993), the case law is still not quite as developed as it is for corporations, although that is rapidly changing given the popularity of LLCs. Moreover, LLCs usually lack access to capital markets that public corporations enjoy, and while some LLCs have been brought public there remains a clear preference in the investment community for corporations as the IPO vehicle.

Governance: The owners of an LLC are called "members." Members may manage the LLC themselves or set up a wide variety of management frameworks using the LLC agreement, including a board of "managers" that functions much the same as a board of directors in a corporation. LLCs also may, but are not required to, name officers. LLCs are creatures of contract, and state laws typically give wide discretion to LLC agreement governance. In Delaware, for example, the LLC agreement will control over nearly any default statutory management rule. In the absence of any provision in the LLC agreement, corporate style fiduciary duties will apply. The LLC agreement can eliminate, limit, or expand those duties but cannot eliminate the implied covenant of good faith and fair dealing. Like partnerships, LLC agreements can become very complex and will occasionally result in gridlock between members. Unlike partnerships, LLCs can also be wholly owned by one member (a natural person or another entity) who exercises complete control of the LLC.

Since 1996, Delaware has permitted "series LLCs," which allows an LLC to be subdivided into separate series of "members, managers, [or] limited liability company interests..." with separate rights, powers, or duties with respect to specific property or obligations of the LLC, or with respect to profits and losses associated with specific property or obligations. The debts and other liabilities of a separate series will be enforceable against only that series. Prior to the



advent of the series LLC, achieving that same benefit would have required the formation of separate LLCs to hold separate assets or activities.

Capitalization: LLCs can raise capital by issuing equity interests to new members or by taking on debt. The LLC agreement offers a great deal of flexibility – members regulate how and when new equity may be issued and can create different classes of membership that offer varying levels of voting rights, powers, distribution rights, and duties. Unless prohibited under the LLC agreement, members can also assign or pledge their equity stake in an LLC to a third party. Depending on the terms of the LLC agreement, this assignment can include both the financial interest and membership rights and powers. Subject to a few restrictions under state and federal tax law, profits and losses may be allocated among the members as provided in the LLC agreement.

Personal liability: Similar to a corporation, the debts, obligations, and liabilities of an LLC are solely those of the LLC and no member will be held personally liable for those debts, obligations, and liabilities. This limits the exposure of most LLC members to the amount of their equity contribution and is a significant advantage LLCs have over general partnerships. Most state courts, including Delaware, have applied the same principles for "piercing the veil" to LLCs as they have to corporations.

Tax treatment: An LLC with multiple members is treated as a partnership for tax purposes, enjoying pass-through taxation, unless the LLC otherwise elects corporate tax treatment. Please see the discussion of partnership tax treatment above for important tax information on the taxation of non-United States investors in partnerships. If the LLC meets the necessary requirements, it may opt for S-Corporation tax status, which, although very similar, is slightly different in treatment than partnership taxation and may be more favorable to the members in some circumstances. A single-member LLC is treated as a disregarded entity for income tax purposes unless it elects to be taxed as a C corporation or an S-corporation. Like foreign corporations that invest directly in partnerships, foreign corporations that invest in a single member LLC treated as a disregarded entity may be subject to a 30% branch profits tax on their accumulated earnings and profits effectively connected to a U.S. trade or business carried on through the disregarded entity.

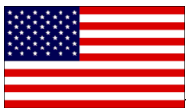
The Internal Revenue Service generally treats each series within a series LLC as a separate and distinct entity.

1.6 The Limited Partnership ("LP")

An LP offers many of the advantages of a general partnership, but also allows for a class of "limited partners" who contribute capital to the partnership, but do not face the joint and several liability of general partners. This entity is attractive because of its ability to attract investors who would be unwilling to join as a general partner. Like a general partnership, limited partnership interests are rarely publicly traded.

Governance: In an LP, only general partners may manage the partnership. For example, under Delaware law, a limited partner may not participate in the control of the business. They may, however, vote on certain issues that affect the partnership, such as dissolution, admission or removal of partners, or an amendment to the partnership agreement. Like a general partnership and an LLC, the partners in an LP can tailor the structure of management to their needs in a variety of ways using a partnership agreement.

Capitalization: An LP can more easily raise additional capital than a general partnership by creating and offering limited partnership stakes. These are attractive to potential investors



because limited partners do not assume joint and several liability for the debts or obligations of the partnership.

Personal liability: An LP must have at least one general partner (a natural person or an entity) who is jointly and severally liable for the debts and obligations of the partnership. Limited partners – so long as they do not participate in control – are not liable for the partnership's debts. Moreover, a limited partner who does participate in the control of the business is only liable to persons who transact business with the limited partner and reasonably believe the limited partner to be a general partner.

Tax treatment: An LP enjoys partnership pass-through taxation treatment. Please see the discussion of partnership tax treatment above for a description of this treatment.

1.7 The Limited Liability Partnership ("LLP")

Like the LLC, the LLP is a relatively recent hybrid creation that combines the limited liability of a corporation with the tax advantages of a partnership. The LLP is, for all practical purposes, a general partnership, except that the debts and obligations of the LLP are solely those of the partnership. An LLP faces additional administrative and filing requirements as trade-offs for this advantage.

Governance: Like a general partnership, the partners manage and control the partnership. They establish the management framework through a partnership agreement that is flexibly drafted to address the partnership's needs.

Capitalization: An LLP raises capital like a general partnership. The partnership agreement may create different classes of partnership interests, with different rights and powers, to attract different classes of investors.

Personal liability: Debts and obligations arising out of an LLP are solely those of the partnership.

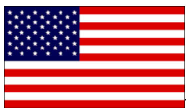
Tax treatment: The LLP enjoys partnership pass-through taxation treatment. Please see the discussion of partnership tax treatment above for a description of this treatment.

1.8 Banks, Joint Ventures and Special Entities

Banks: It is important to understand that none of the entities described above are appropriate for a company that will conduct commercial banking activities, such as receiving deposits or certain trust activities. In the United States, all commercial banks must be chartered by either an individual state or the federal government (a "national association"). Both state and national banks are subject to significant regulation and oversight, and any foreign bank moving a bank or branch to the United States, starting a new bank, or acquiring an existing bank should consult the advice of an attorney experienced with bank regulations. Formation often involves establishing a bank holding company and a formal charter approval process. Although state and national commercial banks are subject to strict oversight, they do enjoy many privileges, such as deposit insurance from the Federal Deposit Insurance Corporation and discounted loans from the Federal Reserve.

Joint Ventures: A joint venture entails a formal collaboration between two separate business entities. Entering a joint venture with an established U.S. company may be an ideal arrangement for a foreign business. Joint ventures can take the form of any of the business entities discussed above or may simply be a contractual agreement. Regardless of the form, joint ventures should be custom tailored to the needs of both entities and formed after close consultation between the venturing parties and their respective legal counsel.

Real Estate Investments: Sales of U.S. real property interests ("USRPIs") are subject to special income tax rules under the Foreign Investment in U.S. Real Property Tax Act



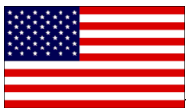
("FIRPTA"). Sales of USRPIs by non-U.S. investors are subject to U.S. federal income tax. To ensure the tax is paid, a purchaser is generally required to withhold 15% of the purchase price and the non-U.S. seller is required to file a U.S. tax return to claim a refund of any amounts withheld in excess of the actual tax due. The sale of stock in a U.S. domestic corporation is treated as a USRPI if the corporation is (or was within the last five years) a U.S. real property holding corporation ("USRPHC"). In general, a U.S. domestic corporation is a USRPHC if the fair market value of USRPIs held by the corporation equals or exceeds 50% of the fair market value of: (1) its USRPIs; (2) its interests in real property located outside the U.S.; plus (3) any other of its assets which are used or held for use in a trade or business.

Real Estate Investment Trusts: The U.S. provides special tax benefits for corporations that qualify as real estate investment trusts ("REITs"). REITs must satisfy strict and detailed requirements intended to ensure that their activities are primarily limited to passive investments in professionally managed real estate investments. REITs pay corporate tax only on amounts not distributed to their stockholders. To the extent that a REIT distributes its income to its stockholders, therefore, its income is subject to a single layer of tax at the stockholder level. In this respect, REITs resemble pass thru entities such as partnerships. Because REITs are treated as corporations, however, non-U.S. investors in a REIT generally are shielded from most U.S. tax and reporting requirements.

Statutory Trusts: Trust relationships have existed under common law for centuries, with courts allowing property ownership to be divided such that a fiduciary would hold legal title to property on behalf of another. Such common law trusts are not legal entities but rather simply contractual fiduciary relationships between a trustee and a beneficiary. In contrast, the Delaware Statutory Trust Act expressly designates trusts formed thereunder ("DSTs") as legal entities and provides a statutory regime to govern their existence. Delaware's law is flexible as to the operation, management and activities of the DST and the limited liability granted to beneficial owners, making DSTs a perfect vehicle for a diverse range of business transactions, but most prevalently for real estate transactions. Unlike a REIT, a beneficial interest in a DST that owns real estate assets is considered a "direct interest in real estate" for U.S. tax purposes, and, thus, can qualify as a tax-deferrable real estate investment by the beneficiary.

1.9 Regulatory Issues

It should be noted that businesses in the United States are subject to a wide variety of regulatory schemes at both the state and federal level. For example, any company issuing equity interests (whether through private placements or public offerings) is likely subject to regulation by the Securities and Exchange Commission as well as state securities laws. Companies merging with or acquiring another company must look closely at applicable antitrust law. Any company with employees will have to consider state and federal employee protections or state workers' compensation schemes. Moreover, companies involved in specific industries may encounter additional regulations. For example, manufacturers need to look closely at environmental regulations, communications companies must address federal communication regulatory issues, and companies engaged in providing consumer goods and services face a number of regulations designed to protect consumers. In nearly any scenario, these regulations may create extensive administrative costs, and the advice of competent legal counsel will be needed to ensure compliance with all related federal and state regulations.



2. Forming Your Business Entity – First Steps

2.1 Introduction

Once the organizers have decided on a particular business entity, there are still many steps to take before opening for business. In most states, a business must apply for a business license and have a registered agent in the state and should consider reserving its name. Moreover, any business with employees or any other business required to file a tax return must obtain a Federal Employer Identification Number from the IRS and consult with the state's tax regulator. In Delaware and many other states, the business entity is formed on the same day as filing so long as the filing meets all statutory requirements. Often the filing process and payment of fees may be completed online. This Section identifies the concrete first steps to forming a particular business entity. Rather than offering an exhaustive list, it highlights the key statutory requirements based on Delaware law.

2.2 The Corporation

In order to form a corporation, a business must file its certificate of incorporation with the Secretary of State. The certificate must contain a variety of information, including the name, registered office address, and a general corporate purpose. Moreover, the certificate must name the incorporator and may name the initial directors. The certificate may provide that the board of directors can amend the by-laws. Stockholder approval will be required for any amendment to the certificate of incorporation after receipt of any payment for stock.

2.3 The General Partnership

A general partnership is formed anytime two or more persons agree to carry-on as owners of a business for profit, and no formal state filing is required, except that many states require the filing of a fictitious name registration for the name under which the partnership is doing business. The partnership is formed whether or not these individuals intend to form the partnership. Nevertheless, a partnership may file a statement of partnership existence with the Secretary of State. Generally speaking, however, the partnership will be governed by the terms of its partnership agreement unless it directly contradicts a mandatory statutory rule.

2.4 The Limited Liability Company ("LLC")

An LLC must file a certificate of formation with the Secretary of State. The certificate must include the name of the LLC and the name and address of the registered agent and the registered office. Members of the LLC must draft an LLC agreement that can become effective after or at the date of filing. There is no requirement to file the LLC agreement.

2.5 The Limited Partnership ("LP")

All general partners must file a certificate of limited partnership with the Secretary of State in order to form an LP. The certificate includes the following information: name of the partnership, name and address of the registered agent and office, and names and addresses of all general partners. Again, the partners should pay careful attention to the partnership agreement, which may take effect after or at the date of filing. There is no requirement to file the partnership agreement.

2.6 The Limited Liability Partnership ("LLP")

A general partnership may file a statement of qualification with the Secretary of State to become an LLP. The statement includes the name of the partnership, the name and address of the registered agent and office, the number of partners, and a statement that the partnership elects to be an LLP. Like the general partnership and LP, the LLP partners should set up their governance framework in a partnership agreement that is not required to be filed.

2.7 Conversion or Redomestication Merger

Sometimes an entity that already exists in a foreign (meaning a non-Delaware) jurisdiction may wish to become a Delaware entity. If permitted under the laws of the jurisdiction in which it currently exists, it can usually convert directly into a Delaware entity by filing of a certificate of conversion and its new certificate of incorporation / formation / etc. in Delaware. It can even change type of entity in the process, for instance by converting from a foreign corporation into a Delaware limited liability company. For purposes of Delaware law, the Delaware entity into which the foreign entity converts is the same entity as the foreign entity.

In cases where the applicable foreign law does not allow for a conversion, such law may allow for mergers. In such instances, a new entity can be formed in Delaware and the foreign entity can merge into that entity. One disadvantage of such a "redomestication merger" process as opposed to a conversion is that the Delaware entity is considered a new entity for purposes of Delaware law. This distinction may have tax effects, may necessitate the receipt of additional regulatory approvals or third-party consents, and may have other ramifications that should be carefully considered.

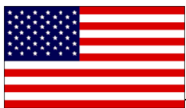
3. Foreign Investment and Operational Considerations; Residency and Material Visa Restrictions for Employees

a. Investing in Your Entity

Generally, transferring funds into a newly formed United States business entity is not difficult. Funds generally flow freely between the United States and most other countries with very limited restrictions or capital controls. There are restrictions with respect to certain countries that are under sanctions from the United States (such as Iran and North Korea) and for companies or persons who are on "watch lists" of potential terrorists or security risks maintained by the government. There is also a reporting requirement on movements of cash (or physical checks which are being carried rather than mailed) in excess of US$10,000 across the U.S. border, but wire transfers generally occur without the need for any reporting by the transferee or recipient.

In addition, banks have "know your customer" rules that will require them to have copies of passports or other identifying and background information on one or more of your executives; usually that information is gathered when opening the account. Generally, opening an account will require a resolution of the Board of Directors (or other governing body if the entity is formed as a partnership or LLC) setting forth the individuals who will have authority over the bank account as well as copies of the account holder's organizational documents, copies of the passports of the authorized signatories, and the entity's taxpayer identification number.

Non-United States investors forming a United States company will want to consider the extent to which they will invest funds as debt or as equity. Like many countries, the U.S. imposes limits on excessive deductions for interest on debt. However, these rules generally only apply for tax purposes; there is not a requirement of minimum capitalization for corporate purposes other than such as is reasonably necessary and appropriate to carry out the business of the enterprise in light of its expected liabilities (i.e., the entity cannot be significantly undercapitalized without risk of piercing the corporate veil). Disallowed interest deductions on debt generally can be carried forward subject to applicable limitations. The United States also has anti-base erosion and anti-hybrid rules that may limit the benefit of interest deductions in some cases.



b. Operational Issues

i. Annual Reports and Filings, Qualifications to Do Business

After forming a corporation, it is important to file annual reports, which for Delaware includes paying an annual franchise tax fee. A Delaware corporation's annual report must state the names and physical addresses of all the directors and officers and the physical address of the corporation's principal place of business. Annual reports in Delaware are due on or before June 30. Note that the franchise tax is calculated based on either authorized capital or on an "alternative basis" which requires the submission of certain U.S. tax schedules and considers the corporation's gross assets, total authorized stock, and total issued stock. The authorized capital method results in higher tax when a large number of shares are authorized. Depending on specifics, filing under the alternative method may or may not ameliorate that result. For this reason, careful thought should be given at the outset to the number of shares authorized.

Failure to file an annual report and pay franchise taxes can lead to the dissolution of a corporation. It is possible to reinstate a dissolved corporation, but penalties will apply, and, in the meantime, stockholders of the corporation may be exposed to liabilities.

There are similar requirements to pay annual franchise taxes for other forms of business entities, but not necessarily to file an annual report. In Delaware, for instance, an LLC pays its annual franchise tax without having to file an annual report. Accordingly, there is no public record in the State of Delaware as to the names or addresses of an LLC's members or managers. And the same franchise tax applies to all Delaware LLCs, regardless of size.

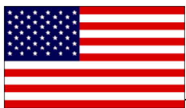
Businesses are also required to file to qualify to do business in each state in which they do business, and each state has a different statute defining "doing business" for these purposes. Usually, having property (including leased property, such as an office) or employees in a state will result in a filing requirement, among other things.

For tax purposes, federal United States income tax returns must be filed annually for corporations; entities taxed on a flow through basis also must file annual information returns. Quarterly estimated tax payments are also required. Once a business qualifies to do business in a state, it will likely need to file tax returns in that state as well. Income earned in the United States will be apportioned among the different states in which a corporation does business.

ii. Additional Investments and Offerings

After an entity is formed, it often requires additional investment, which, as noted above, may come in the form of debt or equity. If additional equity investment is needed, it is often necessary to amend the charter to authorize additional shares of stock. In many cases, investment from new investors comes in the form of new series or classes of stock, most often, new classes of preferred stock (these classes are usually labelled with new letters, so there will be Series A Preferred, Series B Preferred, etc.). These new series of stock may have priority over or be on par with earlier series of stock, so that they receive an investment return either before or alongside of those earlier series.

Preferred stock often includes protections for the holders of such preferred stock, such as rights to veto major corporate actions (sales of the corporation, issuance of dilutive securities, changes to the charter or bylaws), rights to participate in new offerings ("preemptive rights"), rights to participate in sales of stock by other stockholders ("tag-along" or "co-sale"



rights), and even rights to force a sale of stock by other stockholders ("drag-along" rights). This is particularly true in the venture capital or private equity marketplaces, and the National Venture Capital Association maintains model documents that can provide considerable background on how these rights are used and what the documents for such investments look like. Delaware law also provides for special "class votes" when a class of stock is effected in a manner different than other classes, and this special approval can often be critical to major transactions, such as mergers and acquisitions.

All issuances of equity need to be conducted either in accordance with, or pursuant to, an applicable exemption under the United States securities regulations and in accordance with the "blue sky" laws applicable in the states where the securities are being offered for issuance. For wholly owned or closely held corporations, such securities laws will not usually be of any substantive concern. But if shares are being issued to others (whether it be to "friends and family" or to unrelated third-party purchasers), securities laws will typically limit to whom those shares can be issued and require compliance with significant disclosure requirements that vary depending on the nature of the investors and the aggregate amount that they are investing.

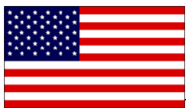
United States securities regulations also provide special and very detailed rules for public offerings. While the overall rules for public offerings are beyond the scope of this overview, the ability to buy or sell stock on the public market may be restricted to certain "registered" shares even after a company has become publicly listed, unlike many other countries where simply "listing" provides access to the market. Thus, most investors in United States companies will negotiate "registration rights" at the time of making an investment. Registration rights agreements set rules for what shares first become liquid following an initial public offering.

iii. Taxes on Transfers to Non-United States Investors

Transfers from the United States to stockholders or investors in another country are potentially subject to withholding taxes. Which withholding taxes apply, however, depends on the underlying facts for specific transfers: is the transfer a return of debt, a payment of interest, a corporate dividend coming out of earnings and profits of the subsidiary, a corporate distribution that is not drawn from earnings and profits (probably a return of capital), a royalty payment, a payment for management services, or something else? Is the transfer governed by a tax treaty between the United States and the country of the recipient?

When a non-United States business forms a United States subsidiary, it will usually enter into an intercompany agreement with that subsidiary which will help ensure that transfers occur in the most tax efficient manner. Withholding rates on different types of income can vary from zero to thirty percent, so properly characterizing payments back to the home country will be very important. Intercompany agreements are usually drafted with input from both the accountants and lawyers advising the business.

Withholding tax issues can be particularly important for non-United States investors in partnerships, limited liability companies, and other pass-through entities. Generally, these entities must determine withholding tax liabilities at the time income is earned, not at the time distributions are made. As a result, there may be withholding taxes due from the entity even when no distributions are made. In addition, a 10% withholding tax may apply to sales of an interest in a partnership or LLC taxed as a partnership that is engaged in a U.S. trade



or business by a nonresident alien individual or foreign corporation.

In general, for a United States corporation, withholding taxes are due at the time of a transfer, and there is an annual report filing by March 15 of the following year. Withholding taxes can often be substantially reduced or eliminated under a tax treaty but taking advantage of the tax treaty will require the timely filing of a form (W-8BEN or W-8BEN-E) with the United States Internal Revenue Service claiming treaty benefits.

iv. Employee Tax Issues

The United States also requires all employers, regardless of what form of entity is used, to withhold taxes from amounts paid to employees, and to file employment tax returns showing all such amounts. Most businesses will use a local payroll servicing company to manage the withholding process.

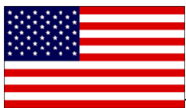
Executives transferred to the United States will have special considerations. Upon becoming a resident in the United States, an executive will be taxed in the United States based on his or her worldwide income (subject to credits for foreign taxes paid) and will be required to fully report all non-United States bank accounts and possibly other holdings. In many cases, an executive may be well-advised to engage in tax planning prior to becoming resident in the United States in order to minimize the impact of these requirements.

c. Special Business or Investment Visa Issues

Anytime a business in the United States wishes to host, train, or employ a foreign national not already authorized to work in the United States, they must obtain the appropriate immigration status for that worker or face penalties. A visa is a passport stamp, issued by the State Department, which allows the foreign national to travel to the United States and request admission under a particular immigration status. In most cases, the underlying immigration status justifying a visa must also be approved by U.S. Citizenship and Immigration Services prior to applying for a visa at a U.S. consulate abroad. A brief discussion of several of the most widely used classes of temporary and permanent visas (statuses) follows in this Section.

Importantly, due to the Covid-19 pandemic, several Presidential Proclamations remain in effect indefinitely, which impose restrictions on the entry of certain travelers who have been physically present in 33 countries, including Brazil, China, India, Iran, Ireland, South Africa, United Kingdom and the European Schengen area during the 14-day period preceding their entry to the United States, including most business visa holders, in an effort to help slow the spread of Covid-19. Certain categories are exempt from the proclamations, including permanent residents and spouses/minor children of U.S. citizens. For certain business travelers, including those working in the critical infrastructure sector, as well as healthcare professionals combatting Covid-19, National Interest Exception waiver (NIE) requests can be submitted to consulate for consideration on a case-by-case basis. If granted, the NIE remains valid for twelve months. Importantly, most U.S. consulates worldwide remain unable to resume routine visa processing at this time with only limited operations or emergency appointments. As a result of the regional travel restrictions and suspension of consular services, international travel to the U.S. has been severely disrupted.

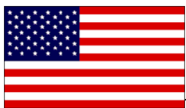
In addition, the U.S. Customs and Border Protection (CBP) continues to restrict "non-essential" travel across U.S. land borders with and ferry travel between Canada and Mexico through September 21, 2021. The restrictions are reviewed monthly and have been continuously extended since the start of the pandemic and remain in effect until rescinded.



This does not, however, affect travel by air between the U.S. and Canada and/or Mexico.

Temporary

- Business Visitor Visas (B-1). This is available to foreign nationals who are surveying potential investment opportunities, attending a conference or trade show, conducting independent research, participating in a short-term training program, or giving a guest lecture or speech. The B-1 status is for a limited period of time (usually less than six months). To qualify for this status, the visitor cannot remain in the United States to manage their investment, perform productive employment, or receive any salary (other than reimbursement for expenses) from U.S. based companies.
- Temporary Worker Visas (H-1B, H-1B1, H-2B, H-3, E-3 L, O, TN). These are available for foreign employees who fall within several specific categories. The H-1B is for specialty occupations and is a very sought-after work visa category for professionals (approximately 85,000 are available annually), which generally are professionals whose position require at least a bachelor's degree or higher, fashion models, or researchers for Department of Defense projects. The E-3 is similar to the H-1B but is limited to citizens of Australia only. The H-1B1 is also similar to the H-1B but is limited to citizens of Chile and Singapore only. H-2B visas are for seasonal work and limited to nationals from designated countries. The H-1B, H-1B1, E-3 and H-2B visas are all subject to annual quotas. H-3 visas are available for training in any field (except graduate medical education) that is not available in the foreign national's home country. Persons with extraordinary ability as evidenced by national or international acclaim may qualify for O visas/statuses. L visas/statuses are for professionals who need to work in the United States at a branch, parent, affiliate, or subsidiary of their current, foreign employer in senior managerial, executive or specialized knowledge positions. The TN is for qualified professional Canadian and Mexican citizens to work in the United States pursuant to NAFTA (effective July 1, 2020, NAFTA was replaced by the United States-Mexico-Canada Agreement (USMCA)).
- Treaty Trader and Investor Visas (E-1, E-2). If a foreign national is from a country that maintains a treaty of commerce and navigation with the United States, (s)he may qualify as an E-1 treaty trader or E-2 investor. To qualify, the foreign national must be engaged in substantial trade or investment and must be an essential employee or possess highly specialized skills.
- International Entrepreneur Rule (IER). In May 2021, the Department of Homeland Security (DHS) announced the International Entrepreneur Rule (IER), which permits the DHS to use parole authority to grant a period of authorized stay, on a case-by-case basis, to foreign entrepreneurs who demonstrate that their stay in the United States would provide a significant public benefit through their business venture and that they merit a favorable exercise of discretion. Entrepreneurs granted parole will be eligible to work only for their start-up business, and for up to five years of authorization with an initial parole for up to two and half years.



Permanent

- Employment Immigrant Visas/Statuses (EB-1, EB-2, EB-3, EB-5). The U.S. State Department issues approximately 140,000 employment-based immigrant visas (otherwise known as green cards) each year. Top priority (EB-1) goes to persons with "extraordinary ability" (international recognition in their fields) and multinational executives with an overseas affiliate, parent, subsidiary, or branch of a U.S. employer. EB-2 visas are issued to foreign nationals who fill positions in the national interest that require the skills of someone with an advanced degree, or to those who possess exceptional ability in their field (although the latter category of EB-2 visas also requires certification from the Department of Labor that qualified U.S. workers are not interested in the position). Third priority goes to EB-3 visa applicants, who are skilled professionals or other workers, and must provide certification from the Department of Labor that qualified U.S. workers are not available in the position. Historically, long wait times ranging from 5-10 years exist for EB-3 visas, especially for foreign nationals from Mexico, India, and China. However, as a result of the pandemic and limited usage of available family-based immigrant visas at consulates, which were added to the employment-based pool of available immigrant visas, there was significant advancement in wait times across all categories, particularly benefitting Indian and Chinese nationals, which trend is forecasted to continue in 2021. EB-5 visas are for immigrant investors who engage in new commercial enterprises that invest at least $1,000,000 in capital ($500,000 in high-unemployment or rural areas) and create full-time jobs for at least 10 U.S. citizens.

There are additional types of immigration statuses that authorize employment in the United States. Whether a foreign national qualifies generally is dependent on the type of work being performed, his or her qualifications, the type of employer, and in certain instances, his or her nationality. Careful consultation with legal counsel experienced in business immigration matters is recommended for any company that is considering employing foreign nationals in the U.S., especially in light of the Covid-19 emergency given the fluid and evolving nature of travel restrictions, proclamations and limited consular operations.

Furthermore, starting October 1, 2021, green card applicants will be required to establish that they have received a complete Covid-19 vaccination series as part of the mandatory panel physician medical exam in order to be deemed eligible for permanent residence, according to the Centers for Disease Control and Prevention (CDC). The CDC has added Covid-19 to the list of vaccinations already required of those seeking permanent residency.