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PRACTICE NOTE ON THRESHOLD ISSUES FOR NON-U.S. COMPANIES WHEN ESTABLISHING A BUSINESS PRESENCE IN THE UNITED STATES

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Issue

As the world's largest economy, the United States is often one of the first places where non-U.S. (foreign) companies wish to do business. While foreign companies can access the U.S. market without establishing a permanent establishment there through the use of U.S. sales agents or distributors, or by licensing their technology to U.S. companies, this Practice Note deals with threshold issues that foreign companies should bear in mind when establishing a business presence in the United States.

Strategy

1. Legal Entity

a. Delaware Corporation

There are no legal entities at the federal/national level in the United States. Legal entities are set up in one of the 50 states or in the District of Columbia, and then are registered to do business in other states, as needed.

While it is legally possible to register a branch of a foreign corporation in one or more states, a branch would subject the foreign corporation to U.S. tax and legal liability. For that reason, it is preferable for the foreign company to establish a separate subsidiary to do business in the United States.

Assuming the subsidiary is wholly (100%)-owned by the foreign parent, it is preferable that the subsidiary be a corporation – sometimes known as a "C corporation" or "C Corp" – rather than a limited liability company (LLC), because a corporation has well-recognized internal management structures, which an LLC does not.

As a rule of thumb, the corporation should be organized either in Delaware, which has a well-developed and flexible corporate law, or in the state in which the company will have its primary base of operations.

Because it is such a well-established jurisdiction, most U.S. equity capital investors require a target company to be incorporated as a C Corp in Delaware. To meet this requirement, a foreign parent of a Delaware company can reincorporate in Delaware by way of a so-called "Delaware flip" (or inversion transaction), whereby the Delaware subsidiary becomes the parent company.

b. Preliminary Issues

As a first step, the availability of the proposed name of the corporation should be determined. A foreign company will normally also want to register its name as a trademark.

In Delaware (and most other states), there is no minimum capital requirement. One point to consider when determining the amount of capital to be paid in, however, is whether the foreign shareholder may wish to avail itself of an "E-2 Treaty Investor" visa to enable one or more key nationals to work at the U.S. subsidiary, which would require that the total amount of the corporation's paid-in capital be of a sufficiently high level for the type of business operation concerned (see discussion of Visas below).

c. Governance

A corporation has a three-tier governance structure: The shareholder(s) elect(s) the Board of Directors; the Board of Directors appoints the officers; the officers manage the day-to-day operations of the company.

Nonresident foreign nationals can be shareholders, directors and officers.

Only one shareholder is required.

The Board of Directors acts as a body; individual directors do not have power to act for or to bind the corporation individually (unless a resolution has been adopted, or a power of attorney has been granted, for that purpose).

Officers are generally (but not necessarily) employees of the corporation and typically include a President, one or more Vice Presidents (optional), a Secretary and a Treasurer. The Board of Directors may appoint other officers, such as a CEO, CFO, Sales Manager, Operations Manager, or any other position it sees fit to create. The officers' powers are stipulated either in the by-laws of the corporation or in resolutions adopted, or powers-of-attorney granted, by the Board of Directors.

The foreign shareholder should take out Directors & Officers insurance to protect the directors and officers of its U.S. subsidiary against liability for their acts or omissions when carrying out their duties, provided they act in good faith.

d. Registrations

In addition to its state of incorporation, the corporation must register, and must appoint a Registered Agent, in each state in which it does business. The Registered

Agent is the state's official contact to which formal notices are sent and on which legal process may be served (for example, to start a lawsuit).

The U.S. subsidiary must apply to the Internal Revenue Service (IRS) for a Federal Employer Identification Number (EIN) in order to file federal tax returns.

e. Outside Counsel

It is recommended that foreign companies engage a competent law firm to set up a corporation, rather than use a corporate services company, to ensure that all necessary formalities are completed on a timely basis. Such formalities include the election of directors and officers, adoption of by-laws, approval of capital contributions, issuance of shares, etc.

2. Intellectual Property; Domain Names

Even before establishing a business presence in the United States, a foreign company should register its trademarks, patents and copyrights in the United States. It should also register its domain name(s) with an ICANN-accredited registrar.

3. Employees

a. Employment Contracts

The U.S. subsidiary should enter into employment contracts with its key employees, setting out the terms and conditions of their employment. The contracts should also include an obligation not to disclose company secrets and possibly a post-employment covenant not to compete. (To be enforceable, any restrictions on employment must be reasonable in time, geographic scope, and the scope of the activities being restricted.) The employment contract might also limit the employee's power to act for and bind the employer – for example, without the prior written approval of the employer's Board of Directors or shareholder(s). When the employee is an officer, however, third parties will not be bound by any restrictions on his ordinary authority unless they have been notified in advance of such restrictions or otherwise have knowledge of them.

The employment agreement should set out the grounds for termination for cause, which should include events such as the closing or sale of the U.S. subsidiary.

A U.S. subsidiary should also publish, and keep updated, an employee handbook that sets out its employment-related policies and procedures.

It is recommended that companies engage competent counsel to draft employment and related agreements and an employee handbook, and consult counsel whenever the company is contemplating the termination of any employee's employment, with or without cause, to minimize the risk of a lawsuit claiming wrongful termination. Such lawsuits are common in the United States.

b. Compliance

The employer will have to pay employment-related taxes to the state and federal government, on its own behalf and on behalf of its employees (by way of withholding).

Workmen's compensation insurance (which insures the employer against its employees' claims for job-related injury and illness) is mandatory.

Small companies should consider outsourcing their HR administration to a "professional employer organization (PEO)," which manages the companies' human resources, employee benefits, payroll and regulatory compliance. PEOs "co-employ" their clients' employees by becoming the "employer of record for tax purposes." This enables PEOs to file Form W2s (Wage and Tax Statements) for the employees with the federal government, while their clients still retain control and oversight over them.

c. Employee Benefits

U.S. law does not require companies to offer pension plans, profit-sharing plans, medical, disability or life insurance coverage to employees. (The Affordable Care Act of 2010, otherwise known as "Obamacare," requires employers with more than 50 employees to provide health insurance or face tax penalties.) But should they wish to do so, even small companies can economically obtain such benefits for their employees through PEOs.

d. Visas

Non-U.S. citizens cannot work in (or even visit) the United States without an appropriate visa (unless they are from a country where the visa requirement has been waived).

A **B-1 Visa** allows foreign nationals from most countries to visit the United States for up to six months to consult with business associates; negotiate a contract; litigate; attend board meetings; attend a conference or seminar; or participate in short-term training. Under the Visa Waiver Program (VWP), foreign nationals from most countries can enter the United States for such purposes for up to 90 days without obtaining a visa. A B-1 visa holder cannot perform services for, or receive remuneration from, a U.S. company; he must be paid by an employer outside the United States.

To work in the United States temporarily (i.e., not permanently) and be paid by a U.S. company, foreign nationals must obtain one of the visas available to "temporary (nonresident) workers" (as opposed to holders of a permanent resident visa, or "green card"). A summary of the principal visas for temporary workers follows. (N.B. This list is not exhaustive; specialist U.S. immigration counsel should be consulted to determine which visa is most appropriate given each individual's circumstances.)

- **L-1**: This visa is for multinational managers or executives who have been employed for at least one of the three preceding years by the overseas affiliate, parent, subsidiary or branch of the U.S. employer. The applicant's employment outside of the U.S. must have been in a managerial or executive capacity, and the applicant must be coming to work in a managerial or executive capacity. An L-1 visa is normally granted for three years, with extensions possible. For start-up U.S. companies, L-1 visas will only be granted for one year, and extensions will only be granted if the U.S. company can demonstrate that it has conducted "substantial business."

- **H-1B**: This visa category applies to people who wish to perform services in a specialty occupation which requires a bachelor's or higher degree.

  The application process is as follows:
    - The employer ("the petitioner") submits a Labor Condition Application (LCA) to the Department of Labor (DOL), attesting (among other things) that it will pay the temporary worker ("the beneficiary") a wage that is no less than the wage paid to similarly qualified workers, or, if greater, the prevailing wage for the position in the geographic area in which he will be working.
    - After receiving the DOL's certification of its LCA, the employer files a Form I-129 (Petition for a Nonimmigrant Worker), together with the DOL-certified LCA, with the appropriate U.S. Citizenship & Immigration Services Service Center.
    - Once the Form I-129 petition has been approved, the prospective worker outside the United States first applies for an H1-B visa at a U.S. embassy or consulate, and then applies to U.S. Customs and Border Protection (CBP) for admission to the United States in H-1B classification.

  The H-1B visa has an annual limit ("cap") of 65,000 visas each fiscal year. The first 20,000 petitions filed on behalf of beneficiaries with a U.S. master's degree or higher are exempt from the cap. Cap numbers are often used up very quickly, so it is important to plan in advance to file for an H-1B visa that is subject to the annual H-1B numerical cap. The U.S. government's fiscal year starts on October 1. H-1B petitions can be filed up to six months before the start date (i.e., on April 1).

  [An **H-2 Visa** is for temporary workers. An **H-3 Visa** is for trainees.}

- **E-2 (Treaty Investor)**: The E-2 nonimmigrant classification allows a national of a treaty country (a country with which the United States maintains a treaty of commerce and navigation) to be admitted to the United States when investing a substantial amount of capital in a U.S. business. Certain employees of such a person or of a qualifying organization may also be eligible for this classification.

  To qualify for E-2 classification, the treaty investor must:
    - Be a national of a country with which the United States maintains a treaty of commerce and navigation
    - Have invested, or be actively in the process of investing, a substantial amount of capital in a bona fide enterprise in the United States

- Be seeking to enter the United States solely to develop and direct the investment enterprise. This is established by showing at least 50% ownership of the enterprise or possession of operational control through a managerial position or other corporate device.

A "substantial amount of capital" is:

- Substantial in relationship to the total cost of either purchasing an established enterprise or establishing a new one
- Sufficient to ensure the treaty investor's financial commitment to the successful operation of the enterprise
- Of a magnitude to support the likelihood that the treaty investor will successfully develop and direct the enterprise. The lower the cost of the enterprise, the higher, proportionately, the investment must be to be considered substantial.

To qualify for E-2 classification, the employee of a treaty investor must:

- Be the same nationality of the principal alien employer (who must have the nationality of the treaty country)
- Meet the definition of "employee" under relevant law
- Either be engaging in duties of an executive or supervisory character, or, if employed in a lesser capacity, have special qualifications.

If the principal alien employer is not an individual, it must be an enterprise or organization at least 50% owned by persons in the United States who have the nationality of the treaty country. These owners must be maintaining nonimmigrant treaty investor status. If the owners are not in the United States, they must be, if they were to seek admission to this country, classifiable as nonimmigrant treaty investors.

When structuring their U.S. operations, foreign companies should bear in mind the U.S. visa requirements that apply to its key non-U.S. employees whom it wishes to be employed (and paid) by its U.S. subsidiary. (In certain situations, those requirements might dictate who the shareholders of the U.S. subsidiary should be and how much capital they should invest.) For this reason, it is recommended that foreign companies consult specialist immigration counsel at the earliest opportunity to determine the most appropriate visa(s) to meet their needs for temporary workers, and later to apply for visas on their behalf.

4. Commercial Terms and Conditions and Contracts

The United States is famously legalistic and litigious: Relationships between parties are governed by contracts more than by handshakes, and disputes are routinely referred to the courts for resolution.

To protect themselves against disputes and costly litigation, foreign companies operating in the United States through a U.S. subsidiary should engage competent counsel to draft robust commercial terms and conditions and contracts with clients and suppliers that are governed either by the law of the state where the subsidiary has its base of operations, or by the law of a leading commercial law jurisdiction, such as the State of New York.

A well drafted contract that clearly sets out the terms and conditions of the agreement between the parties in light of applicable U.S. law and custom will minimize disputes, and, when disputes do occur, will enhance a company's bargaining position when negotiating with a client or a supplier.

Conclusion

Finally, a foreign company should always maintain effective control over its U.S. subsidiary. The foreign parent, not local management, should select and appoint counsel to set up its wholly-owned subsidiary and to register its intellectual property rights in the United States. It should be clear from the outset that counsel represents the foreign parent, not the U.S. subsidiary or any of its employees.

The foreign shareholder's representatives should make up at least a majority of the Board of Directors. As a rule of thumb, a board consisting of three directors should be made up of: 1) the foreign shareholder's manager with responsibility for overseeing the U.S. subsidiary (i.e., the person to whom the local manager – who is usually the President of the U.S. subsidiary – reports); 2) the foreign shareholder's finance director responsible for overseeing the U.S. subsidiary; and 3) the President of the U.S. subsidiary. Whenever possible, the legal governance structure of the U.S. subsidiary should parallel the management reporting structure.

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