

### **Entity Formation**

Under US tax law, a legal person includes an individual, trust, partnership, associations, company or corporation. In the US, for-profit enterprise may be organized as branches, associations, partnerships, trust, companies or corporations. Partnerships and companies may have limited or unlimited liability. Non-profit enterprises may be organized as associations, trusts or corporations. We will focus on the following entities:

- For profit branch
- For profit limited liability company (LLC)
- For profit corporation
- Non-profit association
- Non-profit corporation

Where a foreign entity is represented in the US by an agent, it is generally deemed to have a jurisdictional presence (permanent establishment). In such case the foreign entity is subject to suit in US courts. The exception to this is if the agent is independent and operating in the ordinary course of the agent's separate business. It is likely that an agent whose business in the US is limited to the principal's business will be treated as dependent. For this reason, it is generally recommended that a foreign entity establish an independent limited liability presence in the US and that all agents and employees of the foreign entity in the US be employed and compensated by the US entity.

A foreign entity wishing to operate in the US may operate as a branch of the foreign parent. A branch is not a separate corporation or legal entity but is an agency of the parent. A branch has no officers and no separate board of trustees or directors, has no capital structure, and its liabilities are pooled with those of its parent. There are no legal formalities to establish a branch. The parent enterprise should register to do business in any US state where it has a business presence (either property, payroll or sales.) A for-profit branch is required to file annual tax returns and annual corporate reports in the states in which it operates and with the federal government. The annual tax return must report and allocate the world-wide revenues and expenditures of the parent. A branch is considered to be a permanent establishment.

A for-profit corporation is established under the laws of the an individual US state. The corporation may have one or more shareholders. Each shareholder has liability limited to its stated capital contribution. A corporation is considered to be separate from its owners. The owners are not subject to suits in US courts, under most Income Tax Treaties, the owners are not subject to US tax reporting. The corporation should register to do business in any US state where it has a business presence. The corporation is required to file annual tax returns and annual corporate reports in the states in which it operates and with the federal government.

A for-profit limited liability company (LLC) is established under the laws of an individual US state. The LLC may have one or more persons as members, each of whom share in the economic results. An LLC with a single foreign member can elect to be treated for tax purposes as a branch or as

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a corporation. This election, once made, may be changed only every 5 years. Depending on the election made, the tax and reporting treatment will be as described above.

A non-profit association does not have limited liability, and the members may be responsible to third parties for the actions of other members. Because the entity is not separate from its members, the members will be considered to have a permanent establishment in the US. A non-profit association is required to file annual tax returns and annual reports in the US states in which it operated and with the federal government. We do not recommend operating as an association.

A non-profit corporation is established under the laws of an individual US state. Unlike a for-profit corporation, a non-profit corporation does not have shareholders. Because there are no shareholders, no person is liable for the debts of a non-profit corporation. A non-profit corporation must usually have a minimum of three trustees. Trustees need not be US persons, however, at least one trustee should be a US person for ease of establishing bank accounts and filing annual reports. A non-profit corporation may be established with or without members. Members have the right to elect trustees, but they have few other rights and may not direct the enterprise or benefit from its revenues or assets. Upon dissolution, the asset of a non-profit corporation must be transferred to another non-profit enterprise, and not to the members or trustees. A non-profit corporations is required to file annual reports in the US states in which it operates and with the federal government.

Both forms of non-profit enterprise may be subject to an annual federal tax equal to two percent of net investment income. There are also state filing fees, dependent on revenue or assets.

A corporation may be established by one US individual and thereafter transferred to any person or persons. We can supply the US individual. A search of available name registry precedes creation. The entity can usually be created in ten business days, at a cost of \$3,000 plus state filing fees. As an example, the filing fees for Texas to reserve a name and record a certificate of formation are \$340. The New York State filing fees for a corporation are \$155, and the California filing fees are \$110. The cost of annual tax returns would depend on the volume of activity and the number of state required. Each state requires a registered agent in the state. If the entity has a trustee or director in the state, this person can fulfill that role. Otherwise, a local representative must be retained at an annual fee of \$350.

An LLC may be established by one US individual and thereafter transferred to any person or persons. A search of available name registry precedes creation. The entity can usually be created in five business days at a cost of \$2,500 plus state filing fees. Again, as an example the filing fees for Texas are \$340. New York State filing fees for an LLC are \$270 plus the cost of publishing twelve notices in local newspapers up to \$1,000. The filing fee for California would be \$80. The cost of annual tax returns would depend on the election made, volume of activity and the number of states required.

A non-profit corporation may be established by one US individual and thereafter transferred to any person or persons. A search of available name registry precedes creation. The entity can usually be created in ten business days, at a cost of \$3,000 plus state filing fees. As an example, the annual fee

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for Texas is less than \$25. In New York the fee ranges from \$35 to \$1,600. The fee in California is \$25. The cost of annual tax returns would depend on the volume of activity and the number of states required.

In addition to the above filing obligations, the Internal Revenue Code (IRC) requires a non-profit entity to file for advance approval of its non-profit status. This is generally referred to as “501(c)(3)” and the “501(c)(3) letter” after the IRC section which establishes tax-exempt status for charitable entities. This process requires extensive reporting of the entity's goals, operations, budgets, principal employees, agents, and trustees. Granting of a 501(c)(3) letter may take many months, but is retroactive to the date the entity was created. If agents of the non-profit entity can assist in the drafting of necessary forms and information, the cost to file can be kept to around \$5,000. California has a separate non-profit filing procedure. New York and Texas rely on the federal determination letter.

A for-profit corporation will have a reporting obligation (and a tax obligation) in states where it has a business presence (people or property). Texas has enacted a franchise tax on corporations. Under this tax, a for-profit corporation is assessed a 4.5% tax on the annual income before deduction for compensation of officers and directors compensation. This tax is paid with the annual report. New York State has a corporate income tax equal to 7.1% of taxable income. New York City has an additional corporate income tax equal to 8.85% of taxable income. New York State and City have other taxes which may apply to a corporation. California has a corporate income tax equal to 8.84% of income. The federal corporate tax has graduated rates from 15 to 35%. We can discuss the tax situation in other states if desired. Note that dividends from a US corporation to most developed nations are taxes at a reduced rate under Tax Treaties.

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