Business Structure

An Overview of Common Business Structures for Foreign Investors

Anna Jinhua Wang

Jeffrey J. White

J. Michael Wirvin

Michael J. Kearney

Robinson+Cole

Choosing the right business structure is a critical first step for foreign persons planning to conduct business in the United States. There are several types of entities available, each with its own unique benefits and limitations. There is no "one-size-fits-all" structure. The "right" choice depends on a foreign person's specific interests and needs. The purpose of this chapter is to provide a high-level comparison of some common business structures used by offshore entities to conduct their U.S. operations and what impact that structure might have on the company's business and financing opportunities.

I. General Considerations

(1) Citizenship/Residency Requirements

The procedure for a foreign person (be that a foreign entity or foreign individual) to establish and form a business entity in the United States is essentially the same as it is for a U.S. person. U.S. citizenship, permanent residency (also known as a green card), or a work visa are not required in order for foreign persons to be owners of a U.S. business entity, nor are they required in order for a foreign individual to serve on the board of directors of a corporation in the United States. However, it should be noted that simply being an owner, stockholder, board member, or employee of a U.S. business entity does not in itself permit a foreign individual to work in the United States. There are very specific immigration and customs requirements that apply to non-U.S. citizens who wish to work and earn income in the United States. These requirements are not covered in this chapter, and are subject to change at any time (please refer to the Immigration Chapter for more information. These should be investigated fully in connection with any plan by a foreign person to establish a U.S. business operation.

(2) Formation Timing and Disclosure Requirements

Once the appropriate entity structure has been determined, it must be formed. The appropriate jurisdiction of formation is also a factor that must be carefully considered. There are 50 states, one federal district, and five territories in the United States. Although they have many similarities, each has its own unique rules and regulations regarding business entity formation. The approach of most U.S. states has been to make the incorporation or formation process as simple and streamlined as possible. In many cases, an entity can be formed in just a few days, and sometimes even the same day, depending on its complexity and the jurisdiction in which it is being established.

The information required by most states to be disclosed publicly by a company in its formation documents is normally quite limited and will generally include: (i) the name of the company, (ii) the names and addresses of its officers and directors, (iii) the location of the company's registered office, and (iv) in some cases, a summary of the total number and classes of shares (or units) issued. Unlike many foreign jurisdictions, where detailed stockholder information is required to be filed and maintained in companies houses or other public registries, details of stockholdings are not generally required to be disclosed publicly by private (non-public) companies in the United States. Notwithstanding the foregoing, note should still be taken of the U.S. Corporate Transparency Act ("CTA"), originally adopted by the U.S. Treasury Department's Financial Crimes Enforcement Network on January 1, 2024. Although enforcement of the CTA has been significantly limited and reduced since its enactment, especially as it relates to domestic U.S. entities with U.S. beneficial owners, the scope and applicability of the CTA still remains the subject of ongoing review with respect to foreign corporations doing business, or otherwise operating in, the United States. For this reason, we advise all companies to discuss the CTA with their professional advisors in connection with the formation of any U.S. entity or when contemplating an expansion of their business operations in the United States.

Furthermore, it should be noted that, apart from the relatively minimal disclosure requirements of most states as they relate to the formation and maintenance of a business entity in that state, foreign owners of U.S. businesses may be subject to other state or federal disclosure and filing requirements depending on the classification of business they operate; the types of products they manufacture, distribute, or sell; and the percentage of the U.S. entity that is owned or controlled by foreign persons. This is particularly applicable to businesses operating in the agricultural, banking, communications, defense, energy, and transportation industries.

(3) Cost of Formation

(a) Filing Fees (State of Formation). The fees charged by a jurisdiction for the filing and acceptance of a business entity formed in that jurisdiction generally range from a few hundred to a few thousand dollars, depending on the jurisdiction and the type of business structure being formed. In addition, all states require entities formed or qualified in that state to file an annual report (or its equivalent) each year to update the information on record for that entity and to maintain the entity in good standing. A relatively small annual fee (generally between $250 and $500) is charged for this annual update. Some states calculate this annual fee for corporations based on the number of shares that have been authorized to be issued by the company. For companies that have authorized large numbers of shares, this calculation can result in significant annual fees. Thus, it is important for companies formed in these jurisdictions to take this into consideration when determining share structure and capitalization.

(b) Filing Fees (Other States). When calculating formation and maintenance costs for U.S. entities, it is also important to consider not only the jurisdiction where the entity will be incorporated, but also whether it will be carrying on business in other jurisdictions. For a company registering its business in one state while maintaining its actual business operations in other states, this company would be required to file as a "foreign" entity in those other states ("foreign" meaning it is not originally formed in those other states). Each such other state will charge the company an application fee and annual reporting fees (usually a few hundred dollars per year). The specific definition of "carrying on business" differs between jurisdictions, but generally, entities will be deemed to be carrying on business in a state if they have an office in the state, hold assets in the state, employ significant numbers or types of employees in the state, or engage in the construction of structures in the state.

(c) Registered Agent Fees. Companies are also required to appoint and retain a registered agent in any state in which they conduct business. The role of the registered agent is to accept service of legal process, such as lawsuits or other legal documents, on behalf of the company in that state. If the company has a physical address or office in a state, in most cases it is permitted to use that address as its resident agent address in the state. If a company does not have a physical address in a state where it is registered to do business, it will need to appoint a third-party to act as its registered agent in that state. There are a number of regional and national corporate services companies that act in this capacity. The cost ranges between $250 and $350 per year for this service in most cases.

II. Types of Business Structures

(1) Corporation

A corporation is an entirely separate and distinct business entity from its owners, whose ownership is represented by shares of stock in the corporation (hence they are also known as "stockholders" or "shareholders"). A corporation may have a sole shareholder, a few, or a large number of shareholders. Corporations may issue different classes of shares and designate different series of shares within a class, thereby allowing a corporation to grant different rights to different shareholders.

Corporations are created and regulated by the corporate laws of their state of incorporation as well as corporate laws (both statutory and common-law) in any other jurisdictions in which they are qualified to conduct business.

The day-to-day activities of a corporation are managed by officers who are appointed by the board of directors, the members of which are elected by shareholders to oversee their interests as owners of the corporation. In essence, the shareholders own the corporation;

the board of directors is elected to oversee the operation of the corporation for the shareholders; and the officers are the operators of the corporation. Both the officers and the directors of a corporation have a fiduciary duty to act in the best interests of the shareholders.

One of the main advantages of incorporation is that personal assets of the shareholders, directors, and officers are protected from creditors of the corporation if certain corporate formalities are observed, such as keeping corporate funds separate from personal funds, holding regular meetings of directors and shareholders, keeping minutes of the meetings, and maintaining detailed financial records. Additionally, if the corporation is a subsidiary of a foreign parent, creating a U.S. corporation can act as a shield for the assets of the foreign parent company and mitigate to some extent the rights of creditors of the U.S. company to bring actions against the parent.

(a) Formation

Corporations are formed through the filing of a Certificate of Incorporation or Articles of Incorporation (commonly called the "charter"), depending on the state, with the appropriate state authority.

The incorporator is the person responsible for establishing the corporation and filing the charter with the appropriate state authority. The incorporator also will appoint the initial board of directors and adopt the bylaws (which are the governing rules by which the corporation operates) by a written consent, executed after the corporation has been formed. Once done, the incorporator will relinquish his or her duties as the incorporator. The board of directors then ratifies the actions of the incorporator, appoints officers, approves the issuance of shares to the shareholders, and approves other matters necessary for the initial stages of the corporation (such as opening a bank account).

(b) U.S. Federal Income Tax Implications[1]

[1] This summary does not contain a comprehensive discussion of all U.S. federal income tax consequences that may be relevant to a foreign investor in view of that investor's particular circumstances, nor does it address any state, local, estate, foreign or other tax consequences of an investment in the United States by foreign investors. Foreign investors are urged to consult with their own tax counsel as to the U.S. federal income tax consequences to such investor as a result of an investment in the United States.

Foreign investors[2] need to consider whether the nature of their activities or investments in the United States is such that they could be treated as engaged in a U.S. trade or business for purposes of U.S. federal income taxation. Foreign investors are taxable on a net basis on any income that is "effectively connected" with the conduct of a U.S. trade or business (effectively connected income, or ECI).[3]

Foreign investors may opt to invest in a U.S. corporation to "block" or avoid realizing ECI. The blocker corporation incurs and pays U.S. federal income tax on its operating income (ECI) and thus blocks such income from reaching the foreign investor. The corporation pays U.S. federal income tax on a net basis (21 percent maximum corporate tax rate for tax years beginning after December 31, 2017 pursuant to the enactment of the Tax Cuts and Jobs Act of 2017). Any net after-tax proceeds distributed by the corporation to the foreign investor generally will not be treated as ECI, but rather will be U.S. source dividend income subject to withholding tax. The foreign investor generally will not have to file income tax returns with the U.S. Internal Revenue Service (IRS) with respect to its investment in the corporation.

Provided that a foreign investor (individual or corporation) undertakes no activities in the United States that would cause the investor to be engaged in the conduct of a U.S. trade or business, the U.S. federal income tax liability of such foreign investor generally will be limited to tax (payable through withholding) at a flat rate of 30 percent (or lower tax treaty rate) on certain gross income from U.S. sources, such as dividends and interest.[4] This type of income is non-ECI and is commonly referred to as "FDAP" (fixed, determinable, annual or periodic) income. The foreign investor may be eligible for benefits (an exemption from, or a reduced rate of withholding) for certain FDAP items under an income tax treaty in effect between the United States and the investor's country of residence.

Accordingly, foreign corporations and individuals that are shareholders in a U.S. corporation are subject to a flat tax rate on U.S. source dividends received from the corporation. If the U.S. payor corporation withholds and remits the proper amounts to the IRS, foreign investors[5] that are individuals or corporations will not be required to file

[2] Individuals who are neither U.S. citizens nor residents of the United States for tax purposes (nonresident aliens) and entities treated as foreign corporations for U.S. tax purposes.

[3] The tax issues associated with investments by foreign investors in U.S. real property interests are beyond the scope of this article.

[4] This article does not address withholding tax relating to foreign accounts under Sections 1471 through 1474 (FATCA) of the Internal Revenue Code of 1986, as amended. FATCA generally imposes a withholding tax of 30 percent on certain gross amounts of income not effectively connected with a U.S. trade or business paid to certain "foreign financial institutions" and certain other U.S.-owned "non-financial foreign entities," unless various information reporting requirements are satisfied.

[5] Foreign investors treated as trusts for U.S. federal income tax purposes are subject to special rules.

U.S. federal income tax returns or pay additional U.S. federal income taxes solely as a result of their investment in the U.S. corporation.

Certain types of income are specifically exempted from the 30 percent tax and thus withholding is not required on payments of such income to foreign investors. The 30 percent tax does not apply to U.S. source capital gains (whether long- or short-term) or to interest paid to a foreign investor on its deposits with U.S. banks. The 30 percent tax also does not apply to interest that qualifies as "portfolio interest" (certain U.S. source interest received by a nonresident alien or foreign corporation with respect to qualifying debt obligations).

(c) Financing Options

Compared to other business structures, corporations have access to a broader range of financing options, including the issuance of equity and the incurrence of debt to fund corporate activities.

In the United States, the default requirement to issue securities (debt and equity instruments) to investors involves registration of such transaction with the U.S. Securities and Exchange Commission (SEC). However, there are various exceptions to this rule, and many business entities choose to raise capital in the form of debt or equity pursuant to certain exceptions from registration. The most common of these exemptions is the "Regulation D" exemption promulgated under the Securities Act of 1933, as amended. While a Regulation D offering allows a corporation to raise capital without the cumbersome registration process required for a public offering, its major drawback is that the securities issued typically will be illiquid, as there will be no public marketplace for the securities of a corporation that is not "public." If a corporation elects to register its securities and conduct a public offering, its securities may then be listed on a public market or stock exchange (such as a tier on the OTC Markets, Nasdaq, or New York Stock Exchange).

Traditional financing options from banks, such as term loans with fixed interest rates and long-term repayment plans, small business loans, and secured and unsecured lines of credit, are also available to corporations.

Under certain circumstances, a foreign parent entity may be able to provide a cross-border guarantee or security arrangement for a debt incurred in the United States by the U.S. subsidiary corporation.

In addition, it is not uncommon for a foreign parent entity to make a loan to the U.S. subsidiary to fund its various stages of operation.

Other fairly traditional ways to access capital for a corporation would include the use of a small business credit card (based on both the owner and the company's credit score, which also requires the owner to be personally responsible for repaying debt on the card) and a corporate credit card (based on the company's credit history and financial performance).

(2) General or Limited Partnership

A general partnership is a business entity managed and operated by at least two people (the partners) who contribute money, property, labor, or skill and expect to share the profits and losses of the business. Each partner in a general partnership has unlimited liability for the partnership's debts and obligations, meaning that each general partner can be sued for the full amount of the partnership's debts and obligations. Each general partner contributes to the day-to-day management of the business and has the authority to make business decisions and legally bind the partnership in entering into contracts. The contributions, responsibilities and liabilities of the general partners are often equal, unless stated otherwise in a partnership agreement signed by all partners.

A limited partnership consists of one or more general partners with unlimited liability who manage the business, and one or more limited partners with limited liability (meaning that limited partners are not responsible for the payment of the partnership's debts with their personal assets) who do not play an active role in the management of the business and have no authority to bind the partnership in entering into contracts.

(a) Formation

There is no filing requirement in most states to form a general partnership. The legal name of a general partnership is based on the names of the partners. Some general partnerships may choose to adopt a fictitious, assumed, or "doing business as" (DBA) name by filing with the relevant state authority.

A limited partnership is formed through the filing of a "certificate of limited partnership" (which name may vary from state to state) with the appropriate state authority. A limited partnership agreement signed by all partners sets the rules of managing the business and defines the rights, responsibilities, and liabilities among the partners.

(b) U.S. Federal Income Tax Implications

A partnership files an annual income tax return with the IRS to report the income, deductions, gains, and losses from its operations, but it does not pay U.S. federal income taxes. Instead, the partnership "passes through" any profits or losses to its partners. Each partner is required to report that partner's distributive share (whether or not the partnership distributes cash to the partner) of the partnership's income, gains, losses, deductions, and credits. Thus, it is possible that partners could incur U.S. federal income tax liabilities without receiving from the partnership sufficient cash distributions to defray such tax liabilities. This situation is commonly referred to as "phantom income." After the end of each fiscal or calendar year, the partnership generally delivers tax information on a Schedule K-1 to the partners necessary for the completion of each partner's income tax return.

If a foreign investor invests in a partnership that is engaged in a U.S. trade or business, the foreign investor will be treated as engaged in a U.S. trade or business. Thus the U.S. trade or business activities of a partnership are attributed to its foreign partners, regardless of how many intermediate partnerships separate the foreign partner from the underlying partnership that is engaged in a U.S. trade or business. Treaty protection is generally not available to foreign partners of a partnership engaged in a U.S. trade or business because most such partnerships have a permanent establishment in the United States. Furthermore, a partnership engaged in a U.S. trade or business must withhold U.S. income tax on any ECI of the partnership allocable to its foreign partners, regardless of whether the foreign partner has actually received a cash distribution.

Generally, gain recognized by a foreign partner from the sale of an interest in a partnership that does business in the United States is ECI. Thus, the foreign transferor partner will be subject to U.S. tax on their gain. The ECI gain will also be subject to 10 percent withholding tax on the amount realized on the sale. The purchaser (transferee) of the partnership interest must withhold tax from the sales proceeds, but if it fails to do so the partnership is required to withhold the amount of the tax plus interest from future distributions to the transferee (purchaser).

Subject to certain exceptions, U.S. federal income tax law imposes a 30 percent tax on interest, dividends, rents, royalties, and other FDAP income derived by a foreign person from U.S. sources. A U.S. (domestic) partnership with FDAP income must collect and remit the tax on behalf of the foreign partner.

(c) Financing Options

Forms of financing options available to partnerships are similar to corporations, although with some limitations. For example, partnerships typically are not publicly traded, and they will normally convert into corporations prior to an initial public offering (IPO).

Moreover, when a partnership applies for a loan or line of credit from a bank, the personal credit history and financials of the partners will be reviewed by the bank in addition to those of the partnership.

When a partnership raises funds through a private offering of securities, it offers its partnership interests for sale. It may permit some or all of the existing partners to invest more capital into the partnership, or bring in new partners with new capital, which has the effect of diluting the percentages of ownership of the existing partners.

(3) Limited Liability Company

A Limited Liability Company (LLC) is a business structure combining structural elements of a corporation with the tax benefits of a partnership. Rules and regulations pertaining to LLCs vary by state.

Owners of an LLC are called members, whose ownership of the LLC is represented by their holding of a certain percentage of membership interests or a certain number of membership units (which are similar to shares of a corporation) of the LLC. An LLC is allowed to have different classes of membership interests or membership units, providing the flexibility to distribute voting rights and profits in different ways. Most states allow members to include U.S. and foreign individuals, corporations, and other LLCs.

LLCs may comprise a single member or multiple members. LLCs can be either member-managed, in which all members participate in the day-to-day operation and decision-making process of the LLC, or manager-managed, in which one or more managers are appointed by members as agents of the company to manage the business. A manager may be a member but does not have to be.

Like corporations, members of LLCs are not personally liable for the LLC’s obligations, debts, or liabilities. Although the maintenance of company formalities is not as stringent for LLCs as it is for corporations, it is generally considered good practice to follow similar guidelines and observe such formalities as corporations.

(a) Formation

LLCs are formed by filing a certificate of formation or articles of organization, depending on the state, with the appropriate state authority. Most states require that names of LLCs end with a certain designator, such as “Limited Liability Company” or “LLC.” Some states may have additional requirements for setting up an LLC.

An organizer, who does not have to be a member, is the person who files the certificate of formation or articles of organization to form the LLC. After formation, the organizer executes organizer resolutions (similar to incorporator resolutions), which list the members and/or managers of the LLC, and thereupon relinquishes the duties of the organizer.

Similar to bylaws of a corporation, the operating agreement of an LLC, signed by all members of the LLC, governs the internal operations of the LLC. While many states do not require operating agreements (without which state default rules apply), it is generally considered good practice for members of an LLC to have an operating agreement to delineate the rights, obligations, and rules pursuant to which the members will own and operate the LLC.

(b) U.S. Federal Income Tax Implications

An LLC may be treated by the IRS as either a corporation, partnership, or a "disregarded entity" (meaning an entity disregarded as separate from its owner for federal income tax purposes), depending on the number of members and any elections filed by the LLC with the IRS.

An LLC with at least two members is classified as a partnership for federal income tax purposes, unless it affirmatively elects to be treated as a corporation. A brief overview of thehe U.S. federal income tax implications of foreign investors investing in partnerships is discussed above (in "General or Limited Partnership"). An LLC with only one member is treated as a disregarded entity and the LLC's income, gains, losses, credits, and deductions are reported on the owner's income tax return, unless it elects to be treated as a corporation.

The check-the-box regulations treat a domestic U.S. LLC with more than one member as a partnership for tax purposes. For LLCs treated as partnerships for U.S. federal income tax purposes, a foreign investor must pay tax on its share of the ECI generated by the LLC, regardless of whether the member has actually received a cash distribution from the LLC. The members of the LLC may override the default classification of the LLC by filing a check-the-box election on IRS Form 8832 (Entity Classification Election) with the IRS. Many foreign investors in LLCs will require the LLC to file a check-the-box election on IRS Form 8832 (Entity Classification Election) with the IRS to be taxed as a corporation, and thus override the default classification of the LLC as a partnership. By checking the LLC "closed", foreign investors can avoid having to file income tax returns with the IRS and paying U.S. income tax on its share of ECI (as would be the case if the LLC were treated as a partnership or a disregarded entity for U.S. federal income tax purposes). Alternatively, many foreign investors opt to invest in a corporation (either a corporation organized in the United States or under the laws of the United States or any state thereof or a foreign entity that extends limited liability protection to every member) to avoid having to file income tax returns with the IRS and paying U.S. income tax.

(c) Financing Options

LLCs have similar financing options as those available to partnerships, as well as limitations. When an LLC raises funds through a private offering of securities, it offers its membership interests for sale.

(4) Branch Office

A foreign company is not required to set up a separate U.S. entity in order to do business in the United States and could instead do so through a branch office. A branch office is an extension of the foreign company that conducts business directly in the United States and does not have its separate legal existence from the foreign company. This exposes the foreign company itself to U.S. tax and legal liabilities with respect to the branch office's operations.

(a) Formation

It is not necessary to form a new entity in order to set up a branch office. The foreign company will need to be registered as a "foreign corporation" (as defined under state law) by filing a certificate of authority to do business in the state where business will be conducted through the branch office.

(b) U.S. Federal Income Tax Implications

A foreign corporation that operates directly in the United States through its branch office will be subject to income tax on the income attributable to its U.S. operations. If the activities of the foreign corporation constitute a U.S. trade or business, the corporation would be subject to U.S. federal income tax on a net basis (21 percent maximum corporate tax rate for tax years beginning after December 31, 2017) and the 30 percent "branch profits" tax.

Foreign corporations are subject to U.S. tax on any income that is ECI. They are also subject to branch profits tax at a 30 percent rate on any deemed repatriations of ECI (generally, earnings and profits generated by the U.S. operations of the foreign corporation to the extent not reinvested in a U.S. trade or business). However, depending upon its country of residence and its ability to qualify for treaty benefits, the corporation might be eligible for an exemption from, or reduced rate of, branch profits tax pursuant to a treaty. Without treaty relief, foreign corporate investors could be subject to tax on ECI at an effective tax rate of 44.7 percent (54.5 percent for tax years beginning before January 1, 2018).

A foreign corporation that does not conduct a U.S. trade or business is nonetheless subject to tax at a flat rate of 30 percent (or a lower tax treaty rate) on the gross amount of certain U.S. source income that is not effectively connected with a U.S. trade or business, generally payable through withholding. Income subject to such a flat tax rate includes, but is not limited to, dividends and certain interest income.

Certain types of income are specifically exempted from the 30 percent tax, and thus withholding is not required on payments of such income to a foreign corporation. The 30 percent tax does not apply to U.S. source capital gains (whether long- or short-term) or to interest paid to a foreign corporation on its deposits with U.S. banks. The 30 percent tax also does not apply to interest that qualifies as "portfolio interest."

(c) Financing Options

Because it is not a separate legal entity, a branch office does not have the option to raise capital from private or public offerings.

Compared to a U.S. entity, a branch of a foreign company may experience additional scrutiny by a bank when trying to open a U.S. bank account.

II. Conclusion

The choice of structure for a particular business depends on many factors. This chapter touches briefly on a few important factors to consider and does not discuss all the factors that may be relevant, such as immigration laws, estate planning considerations, and tax implications for the foreign investors in their home countries. Foreign investors are strongly encouraged to consult with their legal, financial, and tax consultants in both the United States and their home countries to choose a business structure that best suits their business needs.

About Robinson & Cole LLP

Founded in 1845, Robinson & Cole LLP is a U.S. based law firm of more than 265 attorneys with 11 offices throughout the United States, including in the major metropolitan centers of Boston, New York, Washington, D.C., Philadelphia, Miami, and Los Angeles. We are a full-service law firm with experience in areas such as corporate formation, mergers & acquisitions, capital markets, U.S. securities laws, tax, immigration and employment, manufacturing/distribution, intellectual property and technology, construction/real estate, and litigation. The firm represents companies of all sizes, with an emphasis on industrial companies that are small to medium-sized and/or are family owned.

Our International Experience

Robinson & Cole LLP has been representing international companies that wish to do business in the United States for decades. Our lawyers regularly represent clients around the world in connection with cross-border transactions with U.S. companies and with expansion into the U.S. market. We have a long history of advising companies located through Europe, Asia and Australia (among other parts of the world), and we take pride in understanding and adapting to the cross-cultural differences that may exist in how decisions are made based on history, culture and the different legal systems. Our lawyers are leaders in the economic community and have been invited to speak at the White House and the U.S. Department of Commerce events, and by U.S.-based economic development organizations that wish to attract companies to the United States.

Disclaimer

This chapter was prepared by Anna Jinhua Wang, Jeffrey J. White, J. Michael Wirvin, and Michael J. Kearney with Robinson & Cole LLP. Views expressed in this chapter are the authors' own, not that of the International Trade Administration. This chapter does not constitute legal advice. Readers interested in investing in the United States should consult legal counsel.