

## **ESTABLISHING A SUBSIDIARY IN THE U.S. - A NORDIC PERSPECTIVE**

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Many Nordic businesses will try to establish a U.S. presence at some point. Four basic solutions present themselves:

1. Joint ventures or a contract with an American distributor or agent.
2. Establishing a branch office.
3. Establishing a subsidiary.
4. Acquiring an existing entity.

This note only addresses subsidiaries of Nordic companies. Branch offices are rarely attractive for foreign companies because they result in direct exposure for the foreign company to liability in the U.S. and jurisdiction by U.S. courts. In addition, a foreign company doing business in the U.S. would be required to file U.S. federal and state tax returns and pay relevant taxes with respect to their U.S. based income and therefore be subject to U.S. federal tax jurisdiction and scrutiny. Normally the company would pay up to 35% corporate income tax and an additional 30% branch profit tax of the branch's profit, calculated after payment of corporate income tax, i.e. a total of up to 54.5% tax. Pursuant to the respective bilateral treaties between the U.S. and Denmark, Sweden, Iceland, Finland and Norway, the branch profit tax is reduced to 0-5% with respect to companies that meet relevant nexus criteria in the relevant Nordic country.

### **Choice of State and Choice of Entity**

Corporate law in the U.S. is regulated by the individual states, and (with some very special exceptions) corporations and other business entities are incorporated or otherwise established under state law, e.g. as New York corporations or Delaware corporations. The process is very fast and relatively inexpensive, and therefore preexisting "shelf" corporations are rarely used. When deciding where to incorporate a subsidiary, the law, the service level of the state and the geographic scope of the business activities of the subsidiary should be taken into consideration.

Most states offer several choices of business entities, for instance corporations, limited liability companies and several types of partnerships. Corporations have been recognized for a long time, and the body of law governing them is familiar and extensive. Limited liability companies are a relatively new type of business entity, but now recognized in all 50 states. They use different terminology, e.g. members instead of shareholders, managers instead of directors, interests instead of shares and distributions instead of dividends, and limited liability companies provide great flexibility with respect to the structure of management and allocation of distributions. Both offer limited liability. A major difference is the tax treatment of the two types of entities. A limited liability company may opt to be treated as a corporation (for tax purposes) or be treated as a partnership (if it has more members) or an entity disregarded from its owner (if it has one member) whereby the owner and the limited liability company are treated as one tax unit.

Corporations are subject to federal corporate income tax of up to 35% and 30% federal withholding tax on dividends to the foreign parent company, unless a relevant treaty is in place.

Under the Finnish and Danish treaties, the withholding tax is reduced to 0%, under the Swedish and Icelandic treaties the withholding tax is reduced to 5% and under the Norwegian tax treaty withholding tax is reduced to 10-15%, provided that in all cases, the parent company must meet certain nexus requirements in the relevant Nordic country.

Limited liability companies (unless they opt to be treated as corporations for tax purposes) will essentially be treated and taxed as branch offices, i.e. the parent company will pay corporate income tax on its U.S. based profits and branch profit tax on the limited liability company's profit (as reduced by the relevant treaty). The parent entity of a wholly owned limited liability company is also liable for employment related taxes if the limited liability company fails to pay such taxes.

### **Incorporation/Formation**

When organizing a corporation or forming a limited liability company, a short document, referred to as a certificate of incorporation, articles of incorporation, certificate of formation, or by a similar term, depending on the terminology applied in the relevant state for the relevant type of entity, is filed with the relevant corporate authorities in the state. The document must contain the name of the entity, address and typically an agent for service of process (whose function is to receive notice of litigation on behalf of the entity), and, for corporations, the authorized capital, i.e. the maximum number of shares the corporation may issue, and the par value of such shares, if they have any par value. The incorporation/formation typically takes a day or two, but can be done in a matter of hours in some states, and takes longer in a few states. With respect to a corporation, a board of directors and officers will be appointed and bylaws will be adopted. A limited liability company may have managers appointed and typically will adopt a limited liability company agreement, which covers the same issues as a corporation's bylaws and shareholders' agreement would. Apart from the incorporation/formation document, these documents are internal (except for public companies) and it is generally not a matter of public record who the shareholders, directors, members, managers or officers are, although some jurisdictions do require some reporting of such information.

If a business entity engages in activities in other states than the state where it is incorporated/formed, it must typically register in such other states to become authorized to do business there.

### **Management**

The shareholders of a corporation elect the board of directors, but otherwise shareholders only become involved in major decisions such as mergers and dissolutions. The board of directors makes decisions as a group (typically by simple majority decisions) and elects the officers, but the members of the board of directors have no individual authority to execute documents on behalf of the corporation. The officers (typically a chairman of the board of directors, president, treasurer and secretary) are in charge of the daily management and have individual authority to execute documents and contracts on behalf of the corporation. With respect to privately held corporations, there is nothing to prevent overlapping appointments between the directors and officers, although no overlap is required (except for the chairman of the board of directors who,

if appointed, must be a director) and generally there are no restrictions with respect to the nationality of the directors or officers.

Limited liability companies have more flexibility in setting up their management. A limited liability company can be managed directly by the member(s) or it can be managed by manager(s). Managers are not required to be physical persons, but can be other legal entities. A limited liability company can have officers, but often does not, and it is not a legal requirement.

### **Capitalization**

It should be noted that, unlike in the Nordic countries, most states do not have formal minimum capital requirements, but because the owners of an underfunded business entity is at greater risk of being held liable for the subsidiary's debt in the event of an insolvency situation (so-called "piercing of the corporate veil"), a new business entity should be sufficiently funded to meet its obligations. It should also be noted that a well funded business entity is more likely to be viewed as a bona fide business by the U.S. immigration authorities, which is helpful if there are plans for sending foreign nationals to the U.S. for work.

Corporations also distinguish between "authorized" and "issued" capital. The authorized capital is stated in the corporation's formation documents, and specifies the highest amount of shares the corporation may issue without shareholder approval of an amendment to the certificate of incorporation. Typically a new corporation will only issue a portion of the authorized capital, and leave the board of directors with authority to issue additional shares against new capital contributions.

### **Tax Registration and Filing**

Some states provide corporations and limited liability companies with a corporate identification number, but other states do not. All corporations are required to obtain a federal tax ID referred to as an "employer identification number" or "EIN" and file an annual corporate income tax return. The EIN is often used to identify the corporation. Limited liability companies also need to obtain and use an EIN in many situations, e.g. if they plan to open a bank account, have employees or have more than one member.

The states where the business entities are incorporated or formed and authorized to do business will also generally require the entity, if a corporation, to file annual franchise tax returns. The tax treatment of limited liability companies varies considerably in the various states.

Depending on the business entity's activities, the business entity may also need to register for and may be liable for employment related taxes (at state and federal level) and, with respect to goods and services sold, sales and use taxes at state level.

### **Continuing Maintenance of the Business Entity**

It is generally recommended, and in some cases required, to have regular meetings, including annual meetings of the shareholders, board of directors, members and managers to document

relevant decisions and to observe the corporate/limited liability company form, so as to avoid piercing of the corporate veil. Often such meetings may be substituted by a written unanimous consent. Directors and officers (and often managers) also have fiduciary duties and are required to perform their duties in an informed manner with the business entity's interests in mind.

The states where the business entities are incorporated or formed and any states where they are authorized to do business will also generally require a business entity to file an annual report. Sometimes the report contains management information and sometimes it contains financial information, but the reporting format varies considerably from state to state.

### **Purchase of an Existing Business in the U.S.**

Although this note does not address mergers and acquisitions, it should be observed that whether a purchase of an existing business in the U.S. takes form as an asset purchase or a stock purchase or a merger, most buyers would decide to set up a new U.S. business entity as the direct party to the transaction.