



February 2009 – Volume 1, Issue 1

ENTERING THE U.S. MARKET—A SWEDISH PERSPECTIVE

By Linda McCarty

This Article is the first in a series of three and deals with the implications of entering the U.S. market through the establishment of a U.S. entity. Part II will address the legal implications of acquiring an existing U.S. company and how to protect against inheriting the lawsuits and liabilities of the acquired company. Part III will discuss some of the fundamental agreements that need to be in place before doing business in the United States, including shareholders agreements (and operating agreements), employment agreements, license agreements, property leases, purchase and sale agreements; and distributor agreements. Although this Article uses the country of Sweden for illustrative purposes, it is intended to provide information for any foreign company considering entering the U.S. market.

There are a number of ways in which a foreign company can enter the U.S. market. The fundamental choice for a company is generally whether to enter the market through distributors and sales representatives or by establishing a physical presence in the United States. As for the latter, the choice is generally between forming a new entity (or acquire an existing entity) for U.S. operations or enter the market by establishing a branch office of the foreign company. Entering the U.S. market through an entity, whether newly established or through an acquisition, is often thought to be advantageous since it insulates the parent company from any liability of the U.S. subsidiary.

The choice of an appropriate U.S. business entity for your U.S. business venture depends in large part on tax considerations and general business concerns.

This Article will explore some of the choices available to a Swedish company when entering the U.S. market through the establishment of a new business entity. Our next issue of the Global News Bulletin will discuss the legal implications of acquiring an already existing company in the United States and how to protect against inheriting the lawsuits and liabilities of the acquired company.

BUSINESS CONSIDERATIONS

Much like Sweden, the United States has a number of business entities Swedish companies can choose between when they set up operations in the United States. The choice of an appropriate U.S. business entity for your U.S. business venture depends in large part on Swedish and American tax considerations and general business considerations. In addition, the Income Tax Treaty between the United States and Sweden must be closely examined in order to find the best suited entity.

A. Available Business Entities in the United States

1. Corporations.

A U.S. corporation is formed in accordance with State laws by filing Articles of Incorporation or a Certificate of Incorporation with the applicable State agency. A U.S. corporation is a legal entity that exists separately from its owners (known as shareholders or stockholders) and if corporate formalities are adequately followed, the Swedish parent corporation, in its capacity as a shareholder, is generally not liable for the debts and obligations of the U.S. corporation.

State corporate laws are generally well developed and provide a framework for forming and operating a corporation. These laws generally require that the shareholders of the corporation appoint a board of directors to govern the corporation, and officers to run the day to day activities of the corporation.

Laws governing the incorporation of a company must be strictly followed and may vary from state to state.

2. Limited Liability Company

A Limited Liability Company (LLC) is formed in accordance with State laws by filing Articles of Organization with the applicable state agency. The owners (known as members) of a limited liability company are shielded from personal liability for most liabilities incurred by the LLC. The LLC can be managed by its members (similar to a partnership, described below) or by elected managers (similar to a corporation). Most State laws governing limited liability companies can be preempted by a written Operating Agreement among the company's members.

Although the limited liability company type of business entity has been in existence for a relatively short period of time in most States, it has grown quickly in popularity. Born out of antiquated tax laws, the limited liability company remains popular for many businesses with fewer owners due to the greater flexibility in company governance, profit and loss allocations and tax treatment permitted by State laws and Federal tax laws. The LLC is often the preferred

business entity for a Swedish company that is establishing a U.S. wholly owned subsidiary.

3. Sole Proprietorship and General Partnership

The sole proprietorship and the general partnership are the most basic ways to transact business. Neither type of organization requires any formal filing to organize. The owner(s) of both types of organizations have unlimited personal liability for the debts and obligations of the business. Accordingly, proprietorships and general partnerships generally have modest capital needs that can be met from the resources of their owner(s). Both sole proprietorships and general partnerships are managed and controlled directly by their owner(s).

The sole proprietorship has a single owner and a general partnership is automatically created when two or more persons (known as partners) associate to carry on a business as co-owners. While there are generally no State laws that apply only to sole proprietorships, general partnerships are typically governed by some form of a uniform partnership act as adopted by the particular State in which the business is established. The partners may enter into a Partnership Agreement to govern their business relationship, pre-empting many State laws that are applicable only if there is no agreement between the partners. A general partnership dissolves upon death, bankruptcy, or withdrawal of any partner.

4. Other Business Entities

There are a number of other types of entities in which a business can operate, although most are used infrequently or only for specialized businesses, such as physician, lawyer or accounting organizations. Other business entities, which vary under the laws of different States, include limited partnerships, limited liability partnerships, professional corporations or associations, professional limited liability companies and business trusts. It is unlikely that a Swedish company doing business in the United States would choose to operate under any of these forms.

SWEDISH-AMERICAN TAX CONSIDERATIONS

The choice of business entity is usually driven first and foremost by tax law implications. Once the most beneficial tax structure is determined, the types of business entities that permit the elected tax structure should be considered.

A. Corporations.

For tax purposes, a U.S. corporation is taxed as a separate entity apart from its shareholders. If the corporation has profits after paying all of its expenses (including

salaries and health insurance it pays for its employees), the corporation pays tax on those profits. When the profits are later distributed to the shareholders, the shareholders pay personal income tax on the dividends as well. This combination of a corporate income tax, followed by a personal income tax, is commonly referred to as double taxation. The double taxation of corporate earnings is a primary reason why business owners choose to establish so called "flow through" entities instead of corporations (i.e. partnerships, limited liability companies, limited liability partnerships).

In 2006, Sweden and the United States signed a new Protocol amending the 1994 Income Tax Treaty between the two countries. The most significant change is the elimination of withholding tax on dividends paid by a U.S. subsidiary to a Swedish parent company, so long as the Swedish parent company (i) owns 80 percent or more of the U.S. subsidiary's voting stock during the 12 month period ending on the dividend record date and (ii) qualifies for Treaty benefits as a Swedish tax resident. Prior to the Protocol, dividends paid by a U.S. subsidiary to a Swedish parent company would normally have been subject to a five percent U.S. dividend withholding tax.

B. Partnership/ Limited Liability Company

If a Swedish corporation carries on business in the U.S. through a non-corporate entity such as a partnership or limited liability company, it will be treated as if it is operating in the United States through a branch, and as such be subject to the branch profits tax, in addition to the regular tax on income effectively connected with the conduct of a trade or business in the United States. The branch profits tax is a tax on profits earned in the United States through an unincorporated branch and is intended to be comparable to the withholding tax on dividends that would apply if the branch was incorporated as a U.S. subsidiary. The Branch Profit Tax was created to correct the disparity that existed between doing business in the U.S. through a branch versus a corporate subsidiary.

Similarly to the changes made to the dividend withholding tax rules, the Protocol also provides for the elimination of the U.S. branch level tax on distributions made by the U.S. branch of a Swedish company under circumstances where the Swedish company would have been entitled to complete dividend withholding tax exemption had the U.S. branch activity been carried on through a U.S. corporate subsidiary. Prior to the Protocol, such distributions would normally have attracted a five percent U.S. branch profits tax.