

Investing in US Businesses by Foreign Persons: Common Business and Tax Considerations

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Today's Agenda

1. Overview
2. Common Business Law Considerations
3. Common Tax Considerations
4. Q&A

Part 1

Inbound FDI - Intro

FDI in the US

WHAT IS THE FDI?

- A cross-border investment
- An investor resident in one economy
- A lasting interest in and a significant degree of influence in another economy
- 10% or more ownership

SIGNIFICANCE OF THE FDI

\$4.46 trillion (2019)

MOST INVESTED INDUSTRIES

- Manufacturing (40%)
- Trade
- Information
- Financial & Insurance
- Real Estate
- Scientific
- Technical & professional services

Part 2

Types of Inbound FDI

1. Investment in US entities

EQUITY

- 10% ownership of a US entity.
- Investments in existing US entities through stock or ownership interest purchases.
- Dividends and capital gains income.
- Distributions.

DEBT

- Debt securities (e.g., a promissory note) investment.
- Loans to US persons secured by US real estate owned by a non-US persons.
- Is it an investment or a lending business activity?

2. Conducting a trade or business in the US

- **MARKETING & SELLING A PRODUCT OR SERVICE**
- **ESTABLISHING A US PRESENCE**
- **CONDUCTING AN ACTIVE TRADE OR BUSINESS THROUGH A US PRESENCE**

3. Investment in the US real estate

4. Becoming a franchisee of a US franchisor

5. Interacting with US entities

- M&A TRANSACTIONS

- JV TRANSACTIONS

Part 3

Choices in Structuring Investments

FDI investment vehicles

- **INDIVIDUALS**
- **FOREIGN ENTITIES**
- **US ENTITIES**

US entity choices (check-the-box options)

- **CORPORATIONS** (per se corporations)
- **PARTNERSHIPS**
- **DISREGARDED ENTITIES**

US entities: a state of formation considerations

- **MOST POPULAR (Delaware, Nevada, New York, etc.)**
- **SALT ISSUES/OPPORTUNITIES (states with no or lower state corporate or personal income taxes)**
- **OTHER CONSIDERATIONS (established & predictable entity law; proximity to customers, vendors, suppliers, etc.; regulatory regime; incentives; privacy; asset protection)**

US entities: legal & regulatory compliance considerations

- Securities
- Employment & labor
- Immigration
- Antitrust
- Anti-competitive abuse prevention laws & regulations
- Data privacy & security
- Industry specific (CFIUS, etc.)
- Anti-terrorism & anti-money laundering
- States' regulations and requirements
- Transfer pricing

Part 4

Tax Considerations

US INBOUND TRANSACTIONS TAX TEST

- 1. IS A PERSON INVOLVED CONSIDERED A “US PERSON”?**
- 2. IF YES, THEN US PERSON IS TAXED ON ITS WORLDWIDE INCOME; IF NO, IS THE US INVESTMENT CONSIDERED “US SOURCE INCOME”?**
- 3. IF YES TO #2, THEN DOES THAT NON-US PERSON ENGAGE IN US TRADE OR BUSINESS ACTIVITIES?**
- 4. IF NO TO #2 OR YES TO #3, THEN IS THE INCOME CONNECTED TO US TRADE OR BUSINESS ACTIVITIES (ECI)?**
- 5. IF NO TO #4, THEN NO TAXATION IN THE US; BUT IF YES TO #4, THEN IS THE ECI SUBJECT TO A SPECIAL TAX REGIME? - IF YES, THEN TAXED UNDER THE SPECIAL TAX REGIME; IF NO, THEN TAXED AT THE US GRADUATED TAX RATES.**
- 6. IF NO TO #2, THEN CAN US SOURCE INCOME BE CLASSIFIED AS FDAP INCOME (Fixed, Determinable, Annual, or Periodic)? - IF NO, THEN NO US TAXATION.**
- 7. IF YES TO #6, THEN ONE NEEDS TO DETERMINE IF FDAP INCOME IS SUBJECT TO IRC OR A TREATY EXCEPTION. - IF YES, THEN NO US TAXATION; BUT IF NO, THEN THERE WOULD BE 30% TAX RATE OR AN APPLICABLE TREATY TAX RATE.**

US SOURCE INCOME

- **The question whether a Non-US person derives US-source income or foreign-source income is of huge importance and complexity. The answer to this question involves the analysis of relevant source-of-income rules as modified by a relevant tax treaty.**
- **Generally, Non-US persons are taxed only on their US-source income. This means that if it is determined that the income is derived from a foreign-source, none of it is likely to be subject to US taxation.**
- **However, certain types of foreign-source income deemed “effectively connected” with US business activities may still be taxed in the United States.**

US SOURCE INCOME: EXAMPLES

- **Interest Income**: generally, sourced to the residence of the obligor. IRC § 861(a)(1). This applies to individuals, corporations and partnerships. There are numerous exceptions.
- **Dividends**: aside from limited exceptions, the source of dividend income is determined by whether the corporation that pays the dividends is foreign or domestic. Dividends paid by US corporations is US-source income. Dividends paid by a foreign corporation is foreign-source income **UNLESS 25% Exception**. This means that: a foreign dividend from a foreign company to a foreign person may result in US-source income.
- **Rents & Royalties**: sourced to the place where the property is used. In other words, under §861(a)(4), “rentals or royalties for the use of or for the privilege of using in the United States patents, copyrights, secret processes and formulas, goodwill, trade-marks, trade brands, franchises, and other like property” constitutes US-source income.
- **Sale of Inventory**: sourced under the rules set forth in §861(a)(6), §862(a)(6), §863(b), and §865(e)(2). **General Rule**: inventory sales are sourced to the place of sale. However, gain from sale of manufactured, extracted or processed inventory is based on the production activities and apportioned between the United States and a foreign country (this was added by the 2017 Tax Reform).

US TRADE OR BUSINESS: EXAMPLES

- In general, a US trade or business exists if the foreign corporation's activities within the United States are considerable, continuous and regular. Both, quality and quantity of activities matter.
- **EXAMPLES:**
 - Consistent attempts to market products and services in the United States – *US trade or business.*
 - Ministerial, clerical or collection-related activities – *No U.S. trade or business.*
 - Agent of a foreign corporation in the United States has authority to conclude contracts and he regularly exercises this authority – *U.S trade or business.*

ECI & ITS EXAMPLES

- **The term “effectively connected income” or ECI is one of the most important concepts in US international tax law. It may include not only US-source income generated by a US trade or business, but also certain foreign-source income closely related to a US trade or business.**
- **EXAMPLES OF ECI:**
 - **All active US source income**
 - **Certain passive US source income**
 - **Certain foreign source income**

Q&A

Conclusion & Contact Info

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