Doing Business Guide - USA

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United States of America

1. About the United States of America ('USA' or 'United States')

- **The United States** is a highly developed country, and continuously ranks high in measures of socioeconomic performance. It accounts for approximately a quarter of global GDP and is the world's largest economy by GDP at market exchange rates.

- **By value**, the United States is the world's largest importer and the second-largest exporter of goods. Although its population is only 4.25% of the world total, it holds 29.4% of the total wealth in the world, the largest share held by any country.

- **The United States** has the most technologically powerful economy globally, and its firms are at or near the forefront in technological advances. The U.S. dollar is the currency most used in international transactions. It is the world's main reserve currency, backed by its economy, military, petrodollar system, linked euro dollar, and large U.S. treasuries market.

2. Incorporation

- Company incorporation in USA is administered at the state level and not the federal level. The process for incorporation may differ from state to state. Usually, Secretary of respective State is the governing authority.

- Before one starts a business, the following shall be the key considerations:

  - **Selecting the proper vehicle:** In USA, for foreign investors, there are two major vehicles for setting up business i.e., Corporations and Limited Liability Company ('LLC'). An incorporated company or C corporation is a separate legal entity from the person or people forming.

  - In contrast, an LLC brings together some features of business partnerships and corporations, although it is more like a partnership. The key differences are highlighted in the subsequent paragraphs.

  - **Choose a State to Register Your Company:** It is important to note that each state has their own set of rules and flexibilities and consequently ease of doing business may differ from state to state. Hence, at the time of selecting a state, one may consider the following factors:

    - Place of business presence
    - Type of protection offered by state to business and owners
    - Sales tax exemption granted by state
    - Ease of incorporation and administration
    - Secrecy of the information provided by the state (e.g., Delaware)
    - Other benefits in the state

  - **Paperwork:** The forms and other requirements for forming an entity may vary between states. Generally, it involves (i) Selecting and reserving a unique name for the business entity; (ii) Filing of Articles of Association, operating agreements, etc. (iii) Obtaining Employer Identification Number ('EIN'), (iv) Filing of certificate of assumed name (v) Appointing a registered agent that can receive legal documents on behalf of the company, and (vi) Obtaining appropriate state tax registrations and business licenses, if any.

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- **Obtain the EIN:** EIN (also known as Federal Tax Identification Number ('TIN') or Federal EIN) is a unique 9-digit number assigned by Inland Revenue Service ('IRS') for the purposes of identification. It is imperative to note that, for any business in the USA, to open a bank account, pay taxes, or often to get a business license, EIN is mandatory.

3. Secretarial Compliance

- Registered agent and office address: Having a registered agent and their address within the state of formation is a requirement to form a company. When a company expands its operations to another state within USA, it will also need registered agent as well as agent's office address in that state. The registered agent for a business entity may be an officer or employee of the company or more often a professional third party, such as the organization's lawyer or a service company. The agent's name and office address are included in the articles of incorporation to give public notice as to where to send the important documents of the Corporation.

- Officers: In the case of Corporation, there is a requirement of a minimum of one director (may be a non-resident). Where more than one shareholder holds the Corporation, it requires more than 1 director. Certain states may also require other statutory officers such as president, CFOs, etc. For Corporations, some states require a corporate secretary (e.g., California), while other types do not (e.g., Delaware). LLCs do not require appointment of Company Secretary. In case of an LLC, a manager is appointed through the operating agreement for managing the affairs of LLC.

4. Corporation vs LLCs

Below is a snapshot of a comparison of the most preferred vehicles for business in USA:

Particulars	LLC	C Corporations
Form of entity	• Separate and distinct legal entity • Managed by either the members or a manager appointed by the members • Members of the LLC have flexibility in structuring the company, including the ability to divide ownership, and voting rights Note: A few types of businesses generally cannot be LLCs such as banks & insurance companies	• Separate and distinct legal entity • Managed by a board of directors that are responsible for major business decisions and overseeing general affairs of the company • The shareholders elect directors. It shall be noted that even shareholders can act as director • Officers that run the day-to-day operations, are appointed by the directors
Number of shareholders	Unlimited number of shareholders	Unlimited number of shareholders
Liability	No personal liability	
Charter documents	Articles of organization / certificate of formation and operating agreement	Articles of Incorporation, Bylaws, Organizational Board Resolutions, Stock Certificates, and Stock Ledger

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Particulars	LLC	C Corporations
Minimum capital need	No minimum capital requirement	
Taxation	Not taxed (unless opts to be taxed at the entity level) i.e., profits and losses are passed through to the members and taxed at their individual tax rates To file Form 1065 by declaring the share of profit of each partner / member	Taxed on its earnings at corporate level and the shareholders are taxed on any dividends distributed To file Form 1120 as its income tax return for profit to be taxed at corporate level
Shareholders' and board meeting requirements	Annual meetings of members or manages is not required. The provisions of the operating agreement may determine any meeting requirements	Annual meeting is mandatory

In case of S Corporation, only 100 shareholders are allowed and only 1 class of stock is permitted. In case the number of shareholders is more than 100, then the S Corporation status is revoked.

5. Direct Taxation

- The United States has a federal system of the government. This means that laws are made at the federal, state, and local levels.
- Corporations formed in the US will be treated as domestic Corporation and is subjected to modified territorial tax regime on US sourced income and certain earnings related to foreign profits.
- Foreign corporations are not subject to US tax except on (i) income effectively connected with US trade or business and (ii) certain passive incomes from US sources.
- Corporate income tax (CIT) is levied by federal and state governments on business profits.
- As highlighted earlier, businesses broadly may fall into two categories corporations paying tax at corporate level (like C Corporations) and pass throughs (like LLCs, S Corporations)
- Foreign Tax Credits ('FTC'): In any year, a taxpayer can choose whether to take FTC as a credit (subject to limitation) for taxes or claim the FTC as a deduction on such foreign income.
- Losses: Net operating losses can be used to offset the company's tax payments in other tax periods to reduce its over-tax liability in the future tax period. Losses generated in tax years before 2018 can be off set without any limitation i.e., 100% can be used. Losses generated 2018 inwards, set off allowed is capped at 80% of the loss amount. Significant limitations could apply for corporations which have experienced a change of control.

- State taxes and Local taxes – Many states impose income or franchise taxes on corporations. State income taxes can vary from one state to another. States taxes range from 0% to 13%. Certain states follow flat rates or progressive rates with various slabs of income. The most common taxable base is federal taxable income, which is modified by state provisions and is allocated to a state based on an apportionment factor consisting of one or more of property, payroll and sales located within their borders. Taxes paid at state level can be claimed as a deduction on expense for Federal law purposes subject to limitations provided under state specific laws.

- Withholding tax:

  - Domestic: Employers are required to withhold federal taxes payable by the employees on the income earned at the time of making the payment of salary on an estimated basis. In addition, tax may be withheld on certain other payments such as pensions, bonuses, commissions and gambling winnings.

  - International: Taxes are required to be withheld from portfolio dividends, interest, rents, and royalties, and certain other types of income paid to non-US payees. The statutory rate is 30% but reduced rates may apply if the recipient is qualified to obtain the benefits of a US tax treaty. Persons paying shall be required to file withholding tax return in Form 1042 & withholding tax certificate in Form 1042S.

- Tax administration:

  - Tax returns: US corporate taxpayers are taxed on an annual basis and the US tax system is based on the principle of self-assessment and voluntary reporting. A corporate taxpayer is required to file an annual tax return (Form 1120) and pay tax by the 15th day of the fourth month following the close of its tax year.

  - Advance payment of tax: Individuals, including sole proprietors, partners, and S corporation shareholders, must make estimated tax payments if they expect to owe tax of USD 1,000 (other than tax already withheld) or more when their return is filed. Corporations must make estimated tax payments if they expect to owe tax of USD 500 or more when their return is filed. The taxpayers shall be required to prepay its estimated tax liability in up to quarterly instalments as prescribed.

  - Taxation for individuals: US citizens and resident aliens are required to file Form 1040 as their tax return on or before 15 April (for taxpayers following calendar year). This is filed based on the Social Security Number ('SSN') i.e., a nine-digit unique number allotted to US citizens, permanent residents, and temporary residents of US. Non-resident aliens with taxable and reportable US gross income must file Form 1040NR as tax return. Non-resident aliens are not required to file Form 1040NR if they are not engaged in a US trade or business during the tax year and if any tax liability on US-source investment (portfolio) income is satisfied by the 30% (or lower treaty rate) withholding tax. The ones who are not eligible to apply for SSN, can apply for Individual Tax Identification Number ('ITIN').

6. Indirect taxation

- The United States does not impose a federal sales tax / value-added tax (VAT) / federal goods and services tax (GST). State 'indirect taxation' refers to any state tax that is not based on income. The most common indirect tax is a state's sales and use tax; other indirect taxes include real estate transfer taxes, telecommunication taxes, commercial rent taxes, and hotel occupancy taxes. These may vary from state to state.

- Sales taxes are a form of consumption tax levied on retail sales of goods and services. All states other than Alaska, Delaware, Montana, New Hampshire, and Oregon collect state-wide sales taxes, as do localities in thirty-eight states.

- Use tax is a sales tax on purchases made outside one's state of residence for taxable items that will be used, stored, or consumed in one's state of residence and on which no tax was collected in the state of purchase.

7. Accounting and audit

- Methods of accounting: The two most common methods of accounting are the accrual basis and cash basis method. The cash basis method can be applied by corporates whose turnover does not exceed USD 25 million. The method must be consistently applied.

- The U.S. Securities and Exchange Commission recognizes that the Financial Accounting Standards Board sets the accounting standard for public companies in the United States. Every person liable for to pay any tax shall be required to maintain proper and accurate accounting records. The same shall be required to be submitted, if asked for, to the tax authorities.

- By law, public companies are required to get their annual financial statements audited by independent auditors i.e., independent CPA or a firm of CPAs. On the other hand, for private entities, or other type of non-corporate entities, the audit is not mandatory.

8. Other taxes and levies

- **Customs duties and import tariffs:** All goods imported into the United States are subject to entry and are dutiable or duty-free in accordance with their classification under the applicable items in the Harmonized Tariff Schedule of the United States. When goods are dutiable on an 'ordinary' basis, ad valorem, specific, or compound duty rates may be levied.

- **Excise duties:** Excise taxes are special taxes on specific goods or activities - such as gasoline, tobacco, or gambling rather than general tax bases such as income or consumption. All fifty states and many local municipalities levy excise taxes of various kinds.

- **Payroll Taxes:** Payroll taxes are taxes paid on the wages and salaries of employees to finance social insurance programs. The amount of payroll tax is withheld by the employer from employees' income. The largest payroll taxes are at a rate of 12.40% to fund Social Security and a rate of 2.90% tax to fund Medicare, for a combined rate of 15.30%. Employers directly remit half of payroll taxes (7.65 percent), with the other half withheld from employees' pay checks.

- **Property taxes:** Most states and local governments impose a variety of property taxes on real property. Most states also impose a tax on business personal property.

- **Environmental tax:** Importers, manufacturers, and sellers of Ozone Depleting Chemicals ('ODCs'), or imported products manufactured using ODCs, are subject to environmental taxes calculated per weight of the ODC. If the weight cannot be determined, the tax is 1% of the entry value of the product.

- **Other state and municipal taxes:** Other taxes that states may impose, in lieu of or in addition to taxes based on income may include franchise taxes and taxes on the capital of a corporation. State and municipal taxes are deductible expenses for federal income tax purposes.

- **Other tax return filing:** Sales and use tax returns must be filed either annually, semi-annually, quarterly, monthly, or semi-monthly, depending on state requirements. Filing frequency is commonly based on the taxpayer's sales volume and the amount of tax that the taxpayer collects during the period. Monthly filing is most frequently required.

Chennai - India
M2K Advisors LLP
7th Floor, Briley One,
No. 30/ 64 Ethiraj Salai,
Egmore, Chennai – 600
008, Tamil Nadu, India

Singapore
M2K Advisors Pte Ltd
The Octagon,
105 Cecil Street, #13-02
Singapore 069534

USA
M2K Advisors Inc
16192 Costal Highway,
Lewes, County of Sussex,
Delaware - 19958

UAE – Dubai
M2K Advisors
701 C Aspin Commercial Tower,
Sheikh Zayed Road, Trade Center
First, Dubai PO Box - 50810

Australia
M2K Advisors Pty Ltd
Unit 605E, 888 Collins St,
Docklands VIC 3008, Australia

For any queries, reach us at:
mukesh@m2k.co.in
support@m2kadvisors.com

M2K Advisors