Operating globally

Sidestepping legal landmines when expanding internationally **Interviewed by Heather Tunstall**

Establishing a foreign subsidiary may have lucrative business advantages, but if you've decided to pursue this strategy, it's important to stay informed, plan ahead and follow proper compliance with both U.S. and international requirements. Failing to do so can result in undesired consequences and potential IRS penalties.

To ensure proper compliance domestically and abroad, engage a solid group of advisers in the initial planning stages, says Sonia Agee, partner at Ropers Majeski Kohn & Bentley PC.

"It is critical to have the right team in place," says Agee. "Generally speaking, that team consists of a U.S. legal counsel, accountancy professionals on both sides of the operations who understand the coordination of the various tax and reporting requirements between the U.S. and foreign jurisdictions, and a foreign counsel who also has the same knowledge and understanding."

Smart Business spoke with Agee about the steps to take when expanding overseas, and how to maintain compliance with both domestic and foreign regulations.

What initial talking points should business owners discuss with their counsel when they've made the decision to expand overseas?

When a business client first comes to us and expresses interest in looking at overseas opportunities, first and foremost we need to get a clear understanding of the goals and strategies for pursuing foreign operations. We assess the specifics of what the company plans to accomplish by expanding overseas, and how it may be different from or impact what they're doing here in the U.S.

Once the company makes the determination to expand internationally, it is critical to ensure that the new business venture is properly structured overseas. The necessary steps will vary widely depending on the jurisdiction in which the company is looking to operate. In addition to U.S. counsel, it is important to have good counsel overseas who has worked with cross-border issues, because there is often a delicate balancing act to making it work overseas, as well as from a U.S. perspective. Not all forms of entity will work for all ventures, so making sure that the foreign venture is properly structured minimizes liability to the company.

Sonia Agee
Partner
Ropers Majeski Kohn & Bentley PC

What potential legal landmines exist with foreign subsidiaries?

Once the setup with regard to the actual structure is determined, you must look at the detailed aspects of the company's operations. The company must coordinate a number of things, including the work force: will it be necessary to hire a foreign work force, or will the company be bringing key individuals from the U.S. or from other parts of the world into that new jurisdiction? In either case, there are both immigration and employment law issues to coordinate in the U.S. as well as from the foreign perspective. For example, if the company plans to replace a local work force by moving overseas, it is imperative to hire employment counsel because, depending on the size of the work force, there may be a number of formal requirements to avoid liabilities.

Additionally, many jurisdictions have varying laws surrounding intellectual property. Some jurisdictions simply don't provide the same protection that we have in the U.S. in terms of intellectual property rights, so it is important to identify those issues and determine the best way to deal with them.

Finally, the company must be sure that appropriate reporting and compliance is in place. There is a myth that if you earn the money overseas and don't bring it back to the U.S., you don't have to report it. The general rule under U.S. tax law is that worldwide income is reportable and taxable in the U.S. If a company is formed as a subsidiary of a U.S. entity, the U.S. entity has a reporting requirement. Conversely, if a company goes overseas and is formed as a 'sister company' to the U.S. company (the ownership of the foreign entity mirrors the ownership of the U.S. company) there are still reporting requirements. Not only must the appropriate forms disclosing the existence of the foreign entity be filed each year, but, in addition, all income from the foreign entity likely needs to be reported here in the U.S., either through the U.S. entity or through the shareholders.

If a company has a foreign bank account for the foreign business, and a U.S. person has signature authority over the account, the U.S. person is required to file a reporting form disclosing the existence of that account as well as their authority over it. There is a significant penalty an individual can incur for failure to report; it can be up to a $10,000-per-year penalty for not reporting a foreign account, so it's very important if you are looking to go overseas that those reporting requirements are dealt with each year. If they're not, every year can carry its own penalty and fine.

What other issues should you consider to get the most benefit from a foreign subsidiary?

Another question to ask is 'Can the entity here in the United States have a subsidiary overseas?' In most instances, the answer is yes, but a U.S. company does not want to inadvertently forfeit U.S. tax benefits by having an entity formed overseas that may not work with the U.S. requirements — for example, S corporations may only have qualified S subsidiaries. A foreign entity may not comply with the requirements and the S status benefits would be lost.

Again, working with foreign counsel to ensure the form of the foreign entity chosen does not present any problems for the intended purposes is extremely important, as there may be other limitations overseas. For example, a company may not be able to have a direct foreign subsidiary due to specific limitations on ownership imposed by the foreign jurisdiction. Each jurisdiction has its own requirements that need to be understood in the context of the proposed foreign operations before making any decisions. <<

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