A Non-U.S. Company's Guide to Doing Business in the U.S.: A Playbook for Accessing the U.S. Market

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For decades, the United States (U.S.) has boasted the largest economy in the world and the largest market for imported goods. This article discusses basic strategies non-U.S. companies use to enter the U.S. market. Other articles explore U.S. federal income tax rules for non-U.S. companies (linked here), monetizing and protecting intellectual property, and other relevant topics.

There are generally two approaches to entering the U.S. market: organically through the entrant's own efforts (such as through direct sales, a representative office, or subsidiary), or inorganically by leveraging an existing business with U.S. operations (for example by acquisition or joint venture).

Direct Shipping to U.S. Customers

One common approach is selling goods and services directly to customers in the U.S. E-commerce and other virtual platforms make this option particularly easy. Despite the ease, this approach is not without its downsides.

By selling directly into the U.S. market, a non-U.S. company may be subject to U.S. Internal Revenue Service (IRS) scrutiny and U.S. taxation. Generally, direct sales constituting a U.S. trade or business will subject the non-U.S. company to federal income tax. While the determination of whether a U.S. trade or business exists depends on the facts and circumstances of each case, the IRS looks to what types of activities the company's employees or agents are performing in the U.S.

This general rule can be modified by an income tax treaty entered into by the U.S. and the seller's home nation. Non-U.S. companies entitled to benefits under such a treaty will not be subject to U.S. federal income tax unless they earn income through a fixed place of business in the U.S.

A non-U.S. company selling directly into the U.S. market may be responsible for reporting income connected to their U.S.-based activities to the IRS and other state or local authorities. Even if the seller's activities do not rise to the level of a U.S. trade or business, a non-U.S. company selling into the U.S. market may want to file a tax return (often called a "protective return") to claim credits and deductions in the event of IRS challenge.

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Even though there is potential for IRS scrutiny, this approach might be appropriate for companies with no interest or capacity to create a physical presence in the U.S.

Contracting with Existing U.S.-Based Company

Companies with less appetite for IRS scrutiny can consider engaging with an existing U.S.-based business. This approach is a contractual relationship, although the parties can be organizationally affiliated. Because the relationship of the parties is governed by contract, it can be quite flexible. For some relationships, a supply and distribution agreement could be the primary contract granting certain rights and responsibilities to the U.S. entity. Other ancillary agreements may govern matters like the right to use trademarks, perform marketing, and distribute products.

Commonly, a non-U.S. company will use contractual relationships to avoid falling subject to the U.S. tax regime. This is possible because the non-U.S. person's business activities will not be materially involved in the production of sales income in the U.S., preventing the establishment of a U.S. trade or business. There are, however, instances where the activities of an agent in the U.S. could be attributed to the non-U.S. company, resulting in U.S. tax consequences.

This approach often works well for companies seeking to sell to American customers in greater volume than could be achieved through the direct shipping model, but that are not yet ready for a dedicated sales force in the U.S.

Representative Office

Not all companies are ready to commit to making an immediate entry into the U.S. By using a representative office, non-U.S. companies can explore the U.S. market and conduct a limited set of activities. For example, non-U.S. companies can use representative offices as an advertising office or a liaison office, gathering data about the market and testing the viability of a business plan. A representative office does not, however, conduct any income-generating activity, so the non-U.S. company would not be subject to U.S. taxation.

Representative offices are a good option for companies looking to understand the American markets, familiarize the consumer base with their products and services, and establish a toehold in the U.S. They are not generally appropriate where the company intends to rapidly expand or conduct targeted sales activity in the U.S.

U.S. Branch Office

A non-U.S. company looking to fully embrace the U.S. market has several options for establishing a more permanent U.S. presence. One such approach would be to create a branch office. A branch office is a direct extension of the non-U.S. company into the U.S. and conducts the same activities as the non-U.S. company conducts elsewhere. A branch office can be created when a non-U.S. company engages in a U.S. trade or business, or it can be created through the operation of a U.S. subsidiary entity that is fiscally transparent, or pass-through, such as a U.S. domestic partnership or limited liability company.

Due to its fiscal transparency, a branch office is not subject to U.S. income tax on its operating profits. Rather, it exposes the non-U.S. company to U.S. taxation, including both the federal income tax and the branch

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profits tax, which taxes a foreign company's profits derived from the operation of businesses in the U.S. The addition of a branch profits tax is intended to level the playing field between entities conducting business in the U.S. directly and those conducting business through a U.S. corporate subsidiary (as dividends from a U.S. corporation would be subject to tax and tax withholding when paid).

Forming a U.S. branch gives a non-U.S. company the ability to conduct business in the U.S. on the same basis as conducted abroad, subject to direct control by the head office. In some instances, where no U.S. domestic pass-through is employed as the branch, a branch office can subject the non-U.S. company to direct liability for the debts and disputes incurred by the branch.

U.S. Subsidiary

Another way to establish a more permanent U.S. presence is to form a U.S. corporate subsidiary, which is distinct and separate from the non-U.S. company. As a separate company, it will be subject to U.S. tax and regulation, but will shield the parent company from those U.S. requirements in most respects.

As a corporation, the subsidiary would be subject to U.S. corporate income tax on all of its income, but the non-U.S. owner would only have U.S. taxable income when it receives dividends from the subsidiary. The branch profits tax would not apply to a corporate subsidiary.

A U.S. subsidiary is an appropriate approach where the non-U.S. company wants to establish a long-term operation in the U.S. that does not require ongoing supervision and management by the foreign parent, and whose legal structure creates limited liability for the foreign parent. This approach is also frequently used by organizations with operating businesses in multiple nations.

Joint Venture or Partnership

Another strategy is to form a cooperative business relationship with an existing U.S. company and divide the earnings from the venture. This is often achieved by the non-U.S. company and U.S. company forming a separate legal entity such as a corporation, limited liability company, or limited partnership to conduct the joint business venture. Both the non-U.S. and U.S. joint venturers would share the profits, losses, costs, and risks associated with the business of the joint venture. How those profits, losses, and risks are allocated among the venturers would depend on the form of legal entity chosen by them.

Joint ventures can have many of the same results as forming a branch office or subsidiary (depending on the joint venture structure), so care is warranted. A joint venture can help companies that are less familiar with the U.S. market obtain a market presence without as robust of an investment and with a "head start" based on the U.S. co-venturer's previous activity. Not all venture partners are created equal, however, and joint ventures can be susceptible to disagreements and unmet expectations.

Acquisition of U.S.-Based Company

If formation of a joint venture presents too many operational challenges to be practical, another approach is for the non-U.S. company to acquire an existing U.S. business. Following an acquisition, the acquired U.S. company can be structured as a branch office or subsidiary, depending on the needs of the foreign company.

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Assuming an attractive acquisition target exists, such an acquisition can be complicated and bear relatively higher transaction costs than some of the organic expansion options. Among other things, acquisitions by non-U.S. companies are not usually able to be structured as tax-free transactions on the same basis as a purely domestic transaction. Acquisitions are, however, an excellent option for foreign companies looking to enter the U.S. market with an established business model and with complete control over future activity (without having to add a potentially disagreeable partner).

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David Brandon is a tax and business attorney who regularly counsels business enterprises, nonprofit organizations, and investors with respect to the tax aspects of domestic and cross-border mergers, acquisitions, sales, joint ventures, commercial transactions, financings, reorganizations, spin-offs, and other significant transactions. In this context he aids clients in structuring tax-free reorganizations, crafting transfer pricing strategies and applying tax treaty principles, implementing strategies responsive to U.S. tax reform, and, where appropriate, counseling clients with respect to obtaining tax opinions and letter rulings. David enjoys learning about his client's commercial and charitable activities abroad and has experience assisting U.S. persons abroad and non-U.S. persons in the United States.

Bryce Parkllan is a tax and business attorney with experience in international tax compliance for multinational businesses, investment funds, and tax-exempt organizations operating in the U.S. and U.S. territories. He assists clients in structuring cross-border acquisitions, integrating legal entities, and ensuring full utilization of U.S. federal tax incentives. Bryce was previously an associate with KPMG LLP, where he focused on international tax consulting and compliance for Fortune 500 companies and high net-worth individuals with international holdings.