

STARTING A  
BUSINESS IN THE  
UNITED STATES

A PRACTICAL GUIDE  
TO LEGAL ISSUES

THIRD EDITION

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## Preface to Third Edition

Since publication of this guide in 1994, the world has witnessed a revolution in communication known as the Internet. As businesses began to exploit the commercial potential of the Internet, they encountered unique new legal issues and opportunities. We at Gibney, Anthony & Flaherty, LLP quickly realized the need to update our guide to address these issues.

This Third Edition is based on information available as of October 1, 2007. It does not cover all applicable laws or provide legal advice on specific questions. This guide should not be used as a substitute for legal counsel.



# Introduction

In this guide, we show how a business that exists outside the United States might be established here and grow to a substantial presence. We point out how American law at the federal, state and local levels may affect decisions that would otherwise be based solely on business concerns.

The introduction of manufactured products into the U.S. involves a broad range of legal issues. We have therefore focused our efforts on a hypothetical manufacturer called “Manufacturer.” Most of the issues discussed in this guide also apply to a service business. Manufacturer has developed a product that is successful in its home country (called “Home Country”), and seeks to expand its business into the U.S. The product (called “Product”) incorporates unique technology, which is patented in Home Country, and valuable unpatented “know-how.” Home Country is a party to the usual international and bilateral treaty networks, including the Paris Convention and the Berne Convention. Home Country also has a tax treaty with the U.S. patterned after the U.S. Model Tax Treaty.

Our discussion focuses on four stages of Manufacturer’s activities in the US:

**Stage I**      *Entering the United States Market*

(Entry into the U.S. through an American distributor, followed by the hiring of an American licensee)

**Stage II**      *Establishing a United States Presence*

(Modest expansion through the opening of an office in the U.S.)

**Stage III**    *Expanding United States Operations*

(More aggressive expansion through a direct U.S. sales force followed by the acquisition of a manufacturing facility in the U.S.)

**Stage IV**    *Doing Business on the Internet*

(Navigating the unique legal issues posed by the Internet and online commerce)

Each stage involves many areas of American law. Some issues are common to more than one stage; others are unique to one. It is thus important for businesses to consult closely with their legal advisors at each stage of development.

Our discussion of each stage of Manufacturer's business is followed by brief summaries of relevant American laws. Before reading these summaries, you may wish to read the more general background material on a variety of American laws in the Appendix.

## *Stage I*

### **Entering**

### **The United States**

### **Market**

#### **The Independent Distributor**

Manufacturer's first contact with the U.S. is through a representative sent to explore the possibility of introducing the Product into the U.S. market. Manufacturer does not plan to establish its own U.S. sales organization, believing it more appropriate to locate distributors, brokers or manufacturer's representatives.

Manufacturer's marketing personnel locate a promising U.S. distributor, called "Distributor." Working with Distributor, Manufacturer will introduce the Product to the American public. During the following months, Manufacturer's representatives will enter the U.S. to monitor Distributor's activities and the public's reaction to the Product.

Under Manufacturer's arrangement with Distributor, Distributor will buy and resell Products in its own name, and will not hold itself out as Manufacturer's agent. Title to Products will pass to Distributor at the port of shipment in Home Country.

Products are manufactured in Home Country. Manufacturer is considering relocating its assembly operations to another country such as Costa Rica,

to take advantage of lower labor costs and possible special trade relations with the U.S. To assure continued quality, key components of the Product will still be manufactured in Home Country.

Legal issues at this stage of development involve:

- Licensing and Distribution
- Corporate Tax
- Trademark and Copyright
- Customs
- Antitrust
- Immigration

## **Licensing and Distribution**

At this early stage, it may be premature for Manufacturer to form its own U.S. sales organization. There are three ways Manufacturer may enter the U.S. markets without its own sales force: (i) hire a distributor, (ii) engage a broker or (iii) engage a representative. Here, Manufacturer has chosen to hire a distributor. Engaging a broker or representative is more prevalent in other industries and creates a different legal relationship than the one between Manufacturer and Distributor.

Regardless of the type of relationship Manufacturer selects, it should make a thorough review of the capabilities and reliability of its U.S. representative. With the help of its legal and financial advisors, Manufacturer can obtain numerous documents that will help it determine, among other things, how long and how successfully Distributor has been in business, what its assets and credit record are, what retail channels it has worked in, whether it can function in the targeted distribution channels for Products and whether it has lost any important accounts.

The Distribution Agreement governs the relationship between Manufacturer and Distributor. The arrangement calls for Manufacturer to sell finished Products to Distributor. The Distribution Agreement should set forth all pricing and delivery terms. Billing and collection are usually Distributor's

responsibility, as is ensuring compliance with local legal and regulatory requirements. While Distributor sometimes develops the initial marketing plan, Manufacturer may want control of the marketing effort. At the minimum, Manufacturer will insist on having significant input into Distributor's marketing efforts and on receiving regular sales reports. Trademark registrations and patent applications are Manufacturer's responsibility.

Distributor may ask to be Manufacturer's exclusive U.S. representative. If the term of the Distribution Agreement is relatively short, exclusivity is frequently granted. The duration of the Distribution Agreement (or the other agreements had Manufacturer chosen another way to enter the U.S.) may be a matter of difficult negotiation. Manufacturer may want to change its method of distribution in the future, perhaps by creating its own sales force. One problem is that when the Distribution Agreement is initially entered into, it may be difficult for Manufacturer to predict the volume of sales. The U.S. representative, on the other hand, will be committing substantial resources to building Manufacturer's U.S. business and expects to be rewarded for its investment for as long as possible.

The Distribution Agreement should address the key questions of duration of the relationship, methods of ending the relationship and fair compensation on termination. Manufacturer may want the right to repurchase Distributor's inventory of Products at cost, in order to facilitate a change in distributors. The Distribution Agreement should also contain a number of technical but important provisions, including a statement that Distributor is an independent contractor with no authority to bind Manufacturer. It should require Distributor to take reasonable steps to avoid product diversion outside the U.S. or into inappropriate retail channels.

Distributor will probably insist on being protected from liability for defects in the Products, while Manufacturer will want to protect against liability caused by Distributor's negligence. The Distribution Agreement will therefore require both parties to obtain appropriate insurance.

## Corporate Tax

Selling through an independent distributor is one way for Manufacturer to enter the U.S. market without paying U.S. tax. The U.S. will seek to tax Manufacturer if it has a business presence in the U.S. Under general U.S. tax concepts, Manufacturer's ongoing sales using a U.S. agent (independent or otherwise) would be a U.S. business presence, potentially subjecting Manufacturer to tax and requiring it to file U.S. tax returns. However, the buy-sell arrangement between Distributor and Manufacturer does not involve an agency relationship, and should not itself give Manufacturer a U.S. business presence. Further, as discussed below, Manufacturer can look to the U.S. Model Tax Treaty to exempt it from U.S. tax.

Under the U.S. Model Tax Treaty, a treaty resident (such as Manufacturer) is not subject to U.S. tax on business profits unless it has a fixed location, a "permanent establishment" (treaty term), such as an office in the U.S. through which it conducts a business. A "dependent" agent with the power to bind Manufacturer is treated as a fixed place of business for this purpose if the agent exercises that power on an ongoing basis in conducting the treaty resident's U.S. business. Whether an agent is "dependent" or "independent" of a treaty resident involves issues such as economic dependency and degree of control. Manufacturer should remain exempt from U.S. tax even if it uses an agent to market Products, provided it limits the agent's authority to soliciting sales. The U.S. is now taking a closer look at agency relationships and asserting dependent status in arrangements previously thought to involve independent agencies.

If Manufacturer's basis for paying no U.S. tax is a treaty exemption, it must file an annual corporate tax return stating the basis for the exemption. The return need not show the results of Manufacturer's U.S. operations. Filing a return also protects Manufacturer's right to offsetting deductions if it is later determined that Manufacturer's exemption claim was incorrect.

Note that U.S. tax treaties do not cover state and local activities. It is therefore possible to be subject to state and local tax, even if the in-state activity would not subject the business to federal tax. Accordingly, one must plan to avoid not only federal tax, but state and local tax as well.

Article 5 of the U.S. Model Tax Treaty is included in the Appendix discussion on Corporate Tax. This Article sets forth the types of fixed presences that will not constitute a sufficient connection to tax a treaty resident's business profits. Each foreign investor should review its Home Country tax treaty with the U.S., since this provision varies from treaty to treaty.

Note, too, that in Stage I Manufacturer's employees will enter the U.S. from time to time to assist in the marketing effort. This must be carefully monitored, so that the employees' authority, presence and activities do not cause Manufacturer to have a fixed place of business in the U.S.

Manufacturer's employees will receive a salary for services rendered in the U.S., and could be subject to U.S. personal income tax. However, the U.S. Model Tax Treaty provides that if an individual does not spend more than 183 days in the U.S. during the calendar year, he will not be subject to tax if his salary is paid by Manufacturer (which has no fixed place of business in the U.S.).

## **Trademark and Copyright**

Manufacturer's first step in entering the U.S. market is to determine whether the "Product" trademark is being used in the U.S. Trademark rights are territorial, so that Manufacturer's trademark rights in Home Country do not automatically apply in the U.S. Manufacturer should ask its U.S. attorney to do a trademark search to see if the "Product" trademark is available.

If the trademark is available, Manufacturer should register it with the U.S. Patent and Trademark Office. Although not required, registration provides several advantages and can give Manufacturer an early priority date should someone else use the trademark.

There are two ways for Manufacturer to begin the registration process before selling Products in the U.S. Manufacturer may file an "intent-to-use" application once its U.S. plans become sufficiently firm. Or, Manufacturer may apply for a U.S. registration based on its Home Country trademark registration under Section 44(e) of the federal trademark law. Unlike intent-to-use, a Section 44(e) application does not require that the trademark be used in the U.S. before the registration is issued.

Distributor's sales of Products establish trademark rights for Manufacturer, and Manufacturer is responsible for policing and protecting the trademark. The Distribution Agreement should require Distributor to monitor third-party use of the trademark and alert Manufacturer if Distributor learns of infringements. Manufacturer (not Distributor) should decide whether to sue an infringer. Distributor should agree not to use the "Product" trademark or any similar mark in any manner without Manufacturer's written approval.

Copyright law may also play a role. Although Manufacturer does not sell literary or artistic items, it may be able to take advantage of copyright protection for advertising and promotional materials, operating manuals, packaging, etc. Because Home Country is a member of the Berne Convention, no formalities are required for Manufacturer to preserve its U.S. copyrights in items created after March, 1989. However, certain formalities (such as a copyright notice) provide added benefits and are recommended. As a non-U.S. copyright owner, Manufacturer is not required to register its copyright to sue for infringement. However, if Manufacturer later forms a U.S. subsidiary which owns copyrightable material, registration with the U.S. Copyright Office will be necessary before the subsidiary sues an infringer.

U.S. laws and regulations on labeling and packaging are critically important to a company introducing its products into the American market. The Fair Packaging and Labeling Act applies to many products. Depending on the contents of its products, a manufacturer may also be subject to regulations of the U.S. Food and Drug Administration, Environmental Protection Agency, Bureau of Alcohol, Tobacco and Firearms, and laws and regulations of the states in which products may be sold. Many of these laws and regulations contain strict requirements for labels and packages, and Manufacturer should consult its U.S. legal advisors before spending significant funds on package and container design.

## **Customs**

In Stage I, Products will be imported into the U.S. To know the amount of duty it must pay on such imports, Distributor (as owner of the goods) must

determine the classification, value and country of origin of these goods.

The classification of all goods imported into the U.S. is governed by the Harmonized Tariff Schedule of the United States (HTSUS). Under the HTSUS, the rate of duty applicable to Products is determined by the classification and country of origin. The HTSUS may have specific categories that control the classification of Products. The country of origin is clear, because all components are manufactured and assembled in Home Country. The determination of value is a highly technical area that is beyond the scope of this analysis.

Manufacturer is considering relocating its assembly operations to Costa Rica. Costa Rica is a designated Beneficiary Developing Country for purposes of the Generalized System of Preferences (GSP), and qualifying products are eligible for preferential duty treatment. However, for preferential duty treatment under GSP, the operations conducted in Costa Rica would have to meet a minimum value-added requirement. This is unlikely if the only operations conducted in Costa Rica are assembly or packing.

Marking requirements must also be considered. All goods imported into the U.S. must be marked with their country of origin (“Made in Home Country”). The country of origin is clearly Home Country when all manufacture and assembly occurs there. Home Country would also be the country of origin when all components are manufactured there, and the Products are merely assembled in Costa Rica. The country of origin is less clear if components are manufactured in a number of countries. Other (non-Customs) marking requirements may also apply.

## **Antitrust**

One question Manufacturer may have is whether U.S. law permits it to grant Distributor an exclusive distributorship. Under U.S. antitrust law, business activity is generally legal unless it creates an unreasonable restraint on trade. Courts have usually found exclusive distributorships reasonable, and thus legal, in view of the legitimate interests of the distributor (e.g., preventing others from benefiting unfairly from its advertising and promotional expen-

ditures.)

Another issue is whether Manufacturer can lawfully set the price at which Distributor will sell Products. For many decades, agreements on maximum or minimum resale prices were prohibited. Recent changes in federal law now direct that pricing agreements may be legal if their pro-competitive effects outweigh their anti-competitive effects. This is a sensitive area of antitrust law, and Manufacturer should be extremely careful when discussing pricing with Distributor, especially since local laws differ from federal laws on this issue.

## **Immigration**

In Stage I, Manufacturer will send Home Country employees to the U.S. to meet with Distributor. B-1 Business visas permit such employees to be admitted to the U.S. for an initial period commensurate with the purpose of entry up to a maximum of one year, with discretionary extensions of up to six months available under appropriate circumstances. Manufacturer's employees in the U.S. on B-1 visas may not engage in gainful employment in the U.S. They must be compensated only by Manufacturer, and the benefits of their activities in the U.S. must accrue predominantly to Manufacturer. They must also maintain a permanent residence outside the U.S.

Manufacturer's employees coming to the U.S. for business trips of less than ninety days may be able to take advantage of the Visa Waiver Program, which allows nationals of certain countries to apply for entry to the U.S. for B-1 type business purposes without obtaining a B-1 visa. However, applicants must meet specific criteria, and certain restrictions are imposed under the program.

# The Independent Licensee

The introduction of Products was a success, and orders have grown to the point that the manufacturing facility in Home Country cannot keep up with demand. Manufacturer must now consider manufacturing Products in the U.S.

Although Manufacturer decides to manufacture locally, it does not wish to acquire a U.S. manufacturing facility. Rather, it licenses the technology and know-how used in manufacturing Products to a company in the U.S. known as “Licensee.” Licensee will also receive the exclusive U.S. license to market Products under the “Product” trademark. The Distribution Agreement with Distributor has been terminated.

Shortly after the License Agreement is signed, trouble develops with the former Distributor. Although the Distribution Agreement is over, Distributor refuses to return remaining inventory to Manufacturer. In addition, Distributor owes \$60,000 to Manufacturer for Products purchased by Distributor. Manufacturer believes it has the right to the inventory, but the Distribution Agreement was unclear on this point. Manufacturer would like to collect the money owed, but has heard rumors that Distributor is insolvent. Above all, Manufacturer wants to avoid a long dispute with Distributor that might interfere with Licensee’s Product launch or impact Licensee’s trade relations in critical distribution channels.

Because Products have been successful and the “Product” trademark has been widely advertised by Distributor, opportunities to market other goods under the “Product” trademark may arise. With astute marketing, the “Product” trademark may be licensed for many types of goods. Manufacturer has received inquiries

from the apparel, sporting goods and food and beverage industries, and must decide which product categories to pursue and which U.S. companies to license.

If it is successful in establishing a licensing program, Manufacturer may discover the price of fame in the trademark community: counterfeiting. Unauthorized Products may turn up in disreputable outlets and on street corners. Manufacturer must then seek solutions to this unwelcome imitation.

Legal issues relating to this phase of development involve:

- Licensing and Distribution
- Corporate Tax
- Litigation
- Anticounterfeiting

## **Licensing and Distribution**

Manufacturer can no longer meet the growing U.S. demand for Products and must produce in the U.S. However, it is not ready for its own manufacturing facility. Manufacturer chooses instead to license the manufacture and sale of Products to Licensee.

There are two licenses at work here. The first covers technology and know-how used to manufacture Products. Manufacturer may charge a separate royalty for technology and know-how or a combined royalty. Licensee and its employees should agree to keep the technology and know-how confidential, to use it only for Products and not to use it after the License Agreement terminates.

The second license is the right to use the “Product” trademark on Products manufactured using the licensed technology and know-how. The key issue here is quality control. For the first time, Manufacturer’s trademark will appear on goods manufactured by others. Manufacturer must supervise the quality of Licensee’s Products to ensure that Manufacturer’s standards are met. Failure to do so can result in the loss of trademark rights.

Many concerns relating to a distribution arrangement also apply to a license. Licensee will probably insist on exclusivity. The license term may be

longer than the distributorship because of Licensee's manufacturing commitment. However, Manufacturer will seek as short a term as possible to keep its options open, as again, it is unaware of how successful sales may be. Manufacturer should have the right to purchase Licensee's inventory after the License Agreement terminates.

Compliance with local laws is Licensee's responsibility, while Manufacturer's responsibility includes filing trademark and patent registrations. The parties should cooperate in developing the marketing plan. Manufacturer expects to license the "Product" trademark for other goods. It hopes that the public will associate these goods with the high quality Products for which Manufacturer is known. These licenses will present many of the same concerns as the Manufacturer/Licensee license. Quality control is the most important issue from both the legal and business perspective.

## **Corporate Tax**

Having appointed a Licensee, Manufacturer can still generate income from the U.S. free of federal tax. Under the U.S. Model Tax Treaty, Manufacturer will receive royalties free from federal tax if it notifies Licensee that Manufacturer is entitled to treaty relief. At year end, Licensee will report to the IRS all payments made to Manufacturer during the year and any tax withheld. Home Country will be notified pursuant to information exchange procedures under the treaty. Although Manufacturer is subject to tax in Home Country there will be no double taxation.

Absent treaty relief, the U.S. would impose a remittance (withholding) tax on royalties paid to Manufacturer. Licensee would be required to withhold tax (and deposit it with the IRS), paying the balance to Manufacturer. The withholding would satisfy Manufacturer's U.S. tax liability, and Manufacturer would not need to file a return.

U.S. tax treaties differ in defining "royalties" and the level of exemption from tax. Each foreign investor must review its home country's treaty in this regard.

We have assumed that Licensee is not related to Manufacturer, and that the royalty rate has been established at arm's length. As explained in Stage III, the

royalty rate is an ongoing issue when the licensee and licensor are related.

Note again that tax treaties do not cover state and local taxes. In general, states have not sought to tax foreign licensors (such as Manufacturer). However, certain states have asserted a taxable presence as to domestic U.S. licensors. This is a developing area of state and local tax law.

## Litigation

Distributor's failure to pay for Products and its reluctance to return inventory give Manufacturer two claims against Distributor. The first is a breach of contract claim for failure to pay money owed (\$60,000 for Products delivered to Distributor but never paid for by Distributor). The second is a claim for an order (injunction) directing Distributor to sell its inventory of Products back to Manufacturer at cost.

In deciding whether to bring the breach of contract claim, Manufacturer must balance the high cost of litigation against the likelihood of success, the amount of expected recovery and the ability of Distributor to pay the judgment. Manufacturer believes it stands a good chance of success at trial, since Manufacturer delivered the goods, the price was clear and Distributor did not pay. However, Distributor will probably raise defenses (for example, that the Products were defective), and may assert its own claim (called a "counterclaim") against Manufacturer (such as a claim for breach of warranty). Manufacturer must also consider the rumors that Distributor lacks the money to pay a judgment.

The claim for return of inventory is less sure of success. Although manufacturers often have the right to buy back inventory from distributors, the Distribution Agreement was unclear on this point. Manufacturer is wary of devoting time and money to pursuing an uncertain claim. It also wants to avoid a long dispute with Distributor that could interfere with Licensee's Product launch. This dispute might have been avoided had the Distribution Agreement clearly stated what would become of inventory upon termination. At the least, Manufacturer could have improved its litigation position through better long-range planning, and might have considered an arbitration agreement to resolve such disputes,

potentially reducing the cost and expediting a resolution.

If Manufacturer pursues its claims against Distributor, Manufacturer may have the option of suing in either state or federal court. Suit could be brought in the state in which the claim arose or the state in which Distributor has its principal place of business. To assist citizens of foreign countries in receiving a hearing free from favoritism in a state court, the U.S. permits citizens of foreign countries to sue U.S. citizens or businesses in federal courts if the amount in dispute exceeds \$75,000. Non-US citizens often take advantage of this opportunity.

## **Anticounterfeiting**

Manufacturer's license of the "Product" trademark for many goods may lead to these goods being copied. Manufacturer, which must protect its trademark, may then find that conventional legal action is unable to stop counterfeit goods.

The reason for this failure is that traditional legal procedures against trademark infringement do not work well against counterfeiters. Trademark owners often serve suspected counterfeiters with a court order requiring that they attend a hearing. However, when the hearing date arrives, the counterfeiters and the counterfeit goods may be gone. Counterfeiters often run "fly-by-night" operations that are difficult to stop if advance notice of legal action is given (as required in traditional American litigation).

Manufacturer should take advantage of special seizure procedures available to combat counterfeit goods. In a well-run anticounterfeiting operation, investigators trained by the trademark owner and its attorneys locate sellers of counterfeit goods and their supply houses. The investigators watch suspected locations and purchase counterfeit goods. This information is then brought to a judge to show a strong likelihood ("probable cause") of counterfeiting. The judge authorizes seizure of the counterfeit goods at specified locations. Seizures are done by investigators and federal marshals, with the trademark owner's attorneys, in a surprise raid with no advance notice to the counterfeiters.

Manufacturer should also ask its investigators to learn (and obtain proof of) the names of persons importing and manufacturing counterfeit goods. Although this can be difficult, it is extremely beneficial when successful.

## *Stage II*

### Establishing

### A United States

### Presence

Although sales of Products have grown over several years, the business has reached a plateau in recent months. Manufacturer suspects that Licensee has become sluggish and inattentive. To revive sales, Manufacturer believes it needs an office in the U.S. to monitor Licensee, oversee product quality and advertising activities, verify sales and royalty reporting and otherwise advise Licensee on its marketing efforts.

After conferring with its financial and legal advisors, Manufacturer decides to form a subsidiary corporation called “Offspring.” Offspring will operate out of one office, located near Licensee’s headquarters in New Jersey. Offspring will be staffed by a small number of executives and support personnel. Most will be Home Country employees who will relocate to the U.S. with their families, but one will be a local expert on U.S. marketing.

Issues arising under Stage II involve:

- Business Organizations
- Corporate Tax
- Immigration
- Employment

## Business Organizations

By establishing a U.S. subsidiary, Manufacturer hopes to avoid the liability and possible tax exposure of branch operations. Manufacturer selects Delaware as the most favorable state of incorporation, because over many years Delaware has developed laws that make running a corporate business easier than in most other states. (Note that in the U.S. internal corporate affairs are governed principally by state law).

Because Offspring will have an office in New Jersey, it must qualify to do business in that state. Qualification involves registration with state authorities, consenting to state jurisdiction for taxation and litigation and filing periodic reports. The name “Offspring, Inc.” must be available in Delaware and New Jersey before Manufacturer can use it for the name of its subsidiary. A name is available if no other corporation is using it or a confusingly similar name in the state.

Manufacturer must select directors and officers of Offspring. It would like to use some of its executives as officers of Offspring. However, these people are accustomed to dealing on behalf of Manufacturer and must take care to hold themselves out in the future as representing Offspring, not Manufacturer. This is crucial for maintaining Offspring’s limited liability. It may also insulate Manufacturer from the jurisdiction of U.S. courts.

The choice of directors is not so clear. Manufacturer would like one or more members of its management to serve on Offspring’s Board of Directors. While this is generally permitted under U.S. law, it may give Offspring’s creditors an argument that Manufacturer should be liable for Offspring’s debts, on the theory that Offspring is merely the “alter ego” of Manufacturer. The directors may also be concerned with personal liability. For this reason, provisions will be included in Offspring’s Certificate of Incorporation relieving its directors of personal liability from their service on the Board of Directors to the fullest extent allowed by law.

## **Corporate Tax**

By opening an office, Manufacturer has established a limited presence in the U.S., one not intended to involve it directly in the sale of Products through Licensee. By operating through a separate entity (Offspring), Manufacturer should have avoided establishing a fixed presence within the meaning of the U.S. Model Tax Treaty (which might have subjected its royalty to U.S. tax). A U.S. subsidiary (such as Offspring) will not by itself give Manufacturer a fixed presence in the U.S. Only if Offspring acts as an agent might it have that effect.

Under the U.S. Model Tax Treaty, it is possible that Manufacturer could directly perform the activities described in Stage II but not have a fixed presence subjecting it to U.S. tax. However, businesses generally house such activities in a U.S. company.

The arrangement between Manufacturer and Offspring is not intended to establish an agency relationship, and the more likely inquiry will involve the question of whether Offspring has been properly compensated for its activity. U.S. companies are sometimes used to negotiate licenses as well as monitor existing licensees. Under this arrangement, the U.S. company is often granted an exclusive license, and sublicenses the intangible property to third parties. The intent is not to create an agency relationship, but one of related licensor/licensee. It is possible that the U.S. might disagree with this characterization of the relationship.

## **Immigration**

In Stage II, Manufacturer will relocate Home Country personnel and their families to the U.S. The types of employees Manufacturer plans to send and the duration of their stay in the U.S. will determine which visa is required. An appropriate nonimmigrant visa may provide employees of Manufacturer with several years of work authorization in the U.S. Since the employees involved are intracompany transferees, the L-1 might be the appropriate visa. To qualify for this visa, the personnel involved must be employed in the U.S. in

an executive, managerial or specialized knowledge capacity and have worked in the same capacity in Manufacturer's foreign office for one full year in the last three years. Spouses and children under twenty-one of L-1 visa holders are entitled to derivative visas. Spouses of L-1 visa holders may apply for U.S. work authorization while in derivative status. Other specifics of the L-1 visa are outlined in the Immigration summary in the Appendix.

Since the U.S. office has been doing business for less than one year, the initial L-1 visa is valid for one year only. However, if Offspring's business sufficiently expands, renewal of the visa for the full term (explained in the Immigration summary in the Appendix) is available.

Alternatively, Manufacturer may be eligible to apply for E visa registration as an E-1 Treaty Trader or E-2 Treaty Investor, and transfer employees to the U.S. on E-1 or E-2 visas. Employees must be nationals of Home Country coming to the U.S. to fill executive, managerial or essential skills positions. They need not have been employed by Manufacturer in the past. E visas are temporary. There is no set limitation on the number of extensions that can be granted. However, E visa eligibility depends on a number of criteria, including the existence of a treaty or similar agreement between the U.S. and Home Country, the determination that Offspring holds the same nationality as Home Country (through an analysis of its ownership) and the size of the investment made or trade conducted. Spouses and children under twenty-one of E visa holders are entitled to derivative visas. Spouses of E visa holders may apply for U.S. work authorization while in derivative status.

H-1B visas may be appropriate for Manufacturer's professional employees or new hires who will fill positions considered "Specialty Occupations" (generally, those requiring a bachelor's degree, or the equivalent in experience, at a minimum). Derivative visas are available for spouses and children of H-1B visa holders. However, such persons may not work pursuant to the terms of their derivative status.

If Manufacturer intends that certain personnel and their families will remain in the U.S. permanently, or at least beyond the limits of most non-immigrant visas, immigrant visas can be applied for (as described in the Immigration summary in the Appendix).

## Employment

In the beginning, Offspring will employ ten people, and must abide by a variety of federal, state and local requirements governing its relationship with employees. Among these requirements are rules concerning minimum wage, discrimination and harassment, family leave, smoking policies, posting of employee rights, accommodation for disabilities and other matters. Even if certain requirements do not apply to an organization with only ten employees, Offspring may want to start complying in anticipation of future growth.

Offspring will need to set its salary structure and determine which benefits to provide (such as health and life insurance or vacation), since many benefits required by law in Home Country are left to the discretion of U.S. employers. Offspring may also wish to enter into employment agreements with key personnel (such as the expert on U.S. marketing), including provisions restricting such employees from competing with Offspring for a limited time after they leave the company.

Although it may be premature at this stage, as Offspring's labor force grows, other employment issues such as employee handbooks, written job descriptions and written company policies will become important. One or more deferred compensation and retirement plans (discussed under that heading in the Appendix) may also be of interest in the future.

## *Stage III*

# Expanding United States Operations

### **Direct Distribution**

Offspring's efforts to revive sales were only partially successful. Although sales of other goods bearing the "Product" trademark are acceptable, the core business of Product sales has lagged. Manufacturer believes that the license method of distributing Products no longer meets its needs. Manufacturer decides to apply its own marketing approach by establishing a direct U.S. sales operation, to be run by Offspring.

Manufacturer's plans call for a significant increase in Offspring's managerial and sales personnel. A larger U.S. headquarters and a warehouse will be required. Both facilities will be located in New Jersey and staffed by Home Country employees and U.S. personnel. Many more Home Country employees will relocate to the U.S. with their families. Manufacturer must be certain that its Home Country production facilities (which have been expanded) can meet the U.S. demand, because the direct distribution plan will require early termination of the License Agreement with Licensee.

This development raises legal issues in the following areas:

- Corporate Tax
- Real Estate and Environmental Law
- Estate Planning

## **Corporate Tax**

Manufacturer will now establish an active sales operation in the U.S. It faces several decisions that impact its U.S. tax exposure and the overall tax cost of remitting income to Home Country.

Manufacturer must decide whether its sales operations should be conducted through a U.S. subsidiary, or a branch. Foreign companies generally conduct their U.S. operations through a U.S. subsidiary, in view of the problems associated with determining a branch's U.S. profit (for taxes and the application of the branch remittance tax), as well as a desire to limit the parent company's liability and U.S. tax exposure. The U.S. also imposes a branch level tax on interest payments attributable to the U.S. operations, which can add an additional layer of complexity to operating in the U.S. through a branch. Note that certain tax treaties provide exemptions from the branch remittance tax if the ultimate stockholders are bona fide residents of the treaty country. If so, the branch remittance tax may not deter branch operations. Manufacturer decides that its sales operation should be conducted through a U.S. subsidiary, Offspring.

U.S. corporate tax will be imposed on the net income from the U.S. operations (after deducting the costs of distributing Products). Generally, the cost of goods supplied by a foreign parent to a separate U.S. entity will be the largest tax deduction. Note that this expense will reduce Offspring's tax yet produce no tax when Manufacturer is paid. For this reason, the U.S. carefully monitors intercompany transactions to ensure that they are arm's length (negotiated as if Manufacturer and Offspring were not related). The U.S. imposes significant reporting and record-keeping requirements to ensure compliance with its arm's-length rules.

Manufacturer must also decide how to finance its U.S. operations. It may

wish to finance the business partly with debt. Although tax treaties significantly reduce withholding taxes on interest and dividends, only interest is deductible in computing net income for federal tax purposes. The U.S. may seek to reclassify intercompany debt as equity if the debt to equity ratio is too high (a factual issue), or may impose “earnings stripping” provisions to limit tax deductibility. These provisions rely on mechanical rules relating to the levels of debt to equity and interest expense as a percentage of income to limit the deduction. Intercompany interest is not deductible, even under an accrual method of accounting, until payment is made to a foreign related company.

At the state and local levels, Offspring will be subject to tax on its business profits in each state in which it has a physical presence (office, warehouse, etc.). Offspring may, however, be able to limit its tax exposure to one state, even though it sells into other states. This would involve locating Offspring’s sales office and warehouse in the same state (in this case, New Jersey) and soliciting sales through traveling salesmen and independent representatives only, with orders being accepted at Offspring’s headquarters and goods being delivered directly from the warehouse to customers. An annual fee will be paid to Delaware, Offspring’s state of incorporation. This fee should be minimal. Offspring may also face other state and local tax consequences, such as the need to collect sales or use tax and state and local payroll taxes.

As for employee tax, Manufacturer will relocate Home Country personnel and their families to the U.S. These individuals will become tax residents in the U.S. and will be subject to the federal and state income tax systems. As residents of the U.S., they are taxed on worldwide income and capital gains. The transition years when an employee arrives in the U.S. or returns to Home Country often present opportunities for tax planning (which should be done before the move takes place).

Local taxes such as state and city income and property taxes may affect an employee’s choice of where to live. Employees often live in one state and work in another. Employees and their employer must also contribute to the U.S. social security system, unless the transferred employee is exempted by a Social Security Totalization Agreement between the U.S. and Home Country. Under such an agreement, if employees from Home Country work for Offspring (a

U.S. corporation) for more than a fixed time (usually five years), they would normally be covered by the U.S. social security system, and the employees and Offspring would pay social security taxes only in the U.S. If Manufacturer sends its employees to the U.S. for less than the applicable time, the Totalization Agreement would require that such employees be covered only by Home Country's social security system and be exempt from the U.S. system. Absent a Totalization Agreement, employees and Offspring could, under certain circumstances, be required to pay social security taxes to both countries.

## **Real Estate and Environmental Law**

To begin direct distribution, Offspring will need office space and a warehouse. As is common at this stage of development, Offspring will lease, rather than buy, these facilities. The issues posed by a long-term office lease are discussed in the Real Estate and Environmental Law summary in the Appendix.

Finding the proper warehouse may be harder than locating office space. Federal and state environmental laws may make it advisable for Offspring to obtain an environmental assessment of the property before signing the lease.

The direct distribution effort will require the transfer of additional Home Country employees, who may stay in the U.S. for extended periods. For many of them, it may make sense to buy, rather than rent, residential property to take advantage of the tax benefits discussed in the Real Estate and Environmental Law summary in the Appendix.

## **Estate Planning**

In Stage III, Manufacturer will transfer to the U.S. many more Home Country employees and their families. Transferred persons must consider whether they are changing their domicile as well as their residence. Domicile involves a more permanent move with no definite intention of returning to Home Country. Non-domiciliaries are subject to U.S. estate tax on the value of their U.S. assets, but domiciliaries are taxed on the value of worldwide assets. Manufacturer's Home Country personnel may therefore want to take

steps to insure they will be non-domiciliaries. Other differences in estate tax rules (more fully explained in the Estate Planning summary in the Appendix) are the levels of assets exempt from estate tax and exemptions from tax for transfers to spouses.

A major consideration for employees is ease of transfer of assets to their families if they die owning U.S. property or if they are domiciled in the U.S. In some states, probate procedures are time-consuming and expensive. Individuals should pay attention to the location and title of bank and securities accounts, title to real estate and their resident state's laws on spousal rights to marital property.

# Manufacturing Facility

Due to Offspring's direct sales methods, demand for Products has increased greatly. Manufacturer discovers that, despite recent expansion, its production facilities in Home Country cannot cope with the increased demand. Manufacturer now believes that Offspring should manufacture some Products for the U.S. market.

Manufacturer will continue to provide finished Products until Offspring can handle the manufacturing needs on its own. Manufacturer will license the Product technology, know-how and "Product" trademark to Offspring, with an appropriate royalty to Manufacturer.

Manufacturer must now transfer to the U.S. Home Country personnel who are familiar with the manufacturing process.

Topics raised by this discussion involve:

- Licensing and Distribution
- Corporate Tax
- Real Estate and Environmental Law
- Immigration
- Employment
- Deferred Compensation and Retirement Plans

## Licensing and Distribution

To manufacture Products, Offspring will become a licensee of Manufacturer's technology, know-how and the "Product" trademark. A license agreement should be signed covering the items discussed in the Licensing and Distribution summary in the Appendix. Although one may question whether Manufacturer and Offspring need a license agreement in view of Manufacturer's ownership of Offspring, there are reasons why a license agreement is a good idea.

First, Manufacturer may face IRS scrutiny of royalty payments from Offspring, and will want to show that the royalties are comparable to those negotiated by parties dealing at arm's length. Also, Manufacturer may decide to sell its U.S. operations in the future. If so, an arm's-length license agreement between Manufacturer and Offspring may be a good starting point for negotiating a new license between Manufacturer and the buyer of the U.S. operations.

## Corporate Tax

The main tax concern once Offspring begins to manufacture (in addition to those applicable to its direct distribution of Products) is how Manufacturer will be taxed on payments from Offspring for technology, know-how and the "Product" trademark that have been licensed to Offspring.

Recall that Stage I involved the receipt of royalties from unrelated U.S. licensees. The same rules govern royalties paid to a related party. However, the U.S. views intercompany transactions as an opportunity to transfer U.S. profits free of tax (or at a greatly reduced rate of tax), and has adopted so-called "super royalty" provisions under which royalties paid for intangible rights must be consistent with the level of income produced by the intangibles. These provisions were originally meant to ensure adequate compensation for U.S. intangibles exported abroad. However, the rules also apply to inbound transfers.

State and local taxes may be increased if the manufacturing facility is located outside the state in which the company maintains its sales office. Other taxes that relate to manufacturing (such as personal property and real estate

taxes) may also come into play, increasing the tax burden and the administrative burden of complying with tax-reporting requirements.

## **Real Estate and Environmental Law**

As explained in the Real Estate and Environmental Law summary in the Appendix, Offspring's options in acquiring a manufacturing facility are a lease, net lease or purchase. Its decision will depend on a number of factors beyond the scope of this analysis.

Regardless of whether Offspring buys or leases its manufacturing facility, it should carefully evaluate the environmental condition of each site. Offspring should do at least a preliminary environmental audit, since in many states the ownership of real property creates liability for environmental problems (including those created before the new owner buys the property). The transaction may also lead to state environmental review.

Running the manufacturing facility will require the transfer of specially trained Home Country employees, who will remain in the U.S. for extended periods. It may make sense for these persons to buy, rather than rent, residential property and take advantage of tax benefits available to home owners.

## **Immigration**

Manufacturer must now transfer to the U.S. Home Country personnel who are familiar with the manufacturing process. The same visa concerns discussed in Stage II apply. Various training visa classifications are available, including J-1 and H-3. If Manufacturer plans to train foreign personnel in the U.S., such trainees can apply for J-1 Exchange visas through an educational and cultural exchange program administered by an organization approved by the Department of State. J-1 trainees are eligible to enter the U.S. for up to eighteen months.

If Manufacturer intends that certain individuals and their families will remain in the U.S. permanently, or at least beyond the limits of most non-immigrant visas, immigrant visas can be applied for as described in the Immigration summary in the Appendix.

## **Employment**

Acquisition of a manufacturing facility raises several new employment law issues. Offspring will need to comply with the safety standards and requirements of the federal Occupational Safety and Health Act (OSHA) applicable to its plant. The fact that many employees will have access to Manufacturer's technology and know-how may necessitate the use of confidentiality and non-disclosure agreements. Depending on the size of the work force and the nature of the industry, it may also be necessary to deal with labor unions.

## **Deferred Compensation and Retirement Plans**

Once Offspring acquires a manufacturing facility, its work force will grow significantly. At this point, Offspring may decide to adopt one or more tax qualified benefit plans (which meet criteria established by federal law and are entitled to certain tax and other benefits). Even though a qualified plan involves a great deal of administrative work, it may be necessary for Offspring to attract the best available employees.

Offspring may consider a defined benefit (pension) plan or a combined profit-sharing and salary deferral (401K) plan. Most U.S. employees would have to be eligible to participate in the plan. Offspring would have several options regarding Home Country personnel, who tend to be the most highly compensated. These options provide planning opportunities that are beyond the scope of this review.

## *Stage IV*

# Doing Business on the Internet

### Preparing to Go Online

Although Manufacturer is realizing satisfactory results from Offspring's sales operations in the U.S., it is acutely aware that consumers are turning more and more to the Internet to locate products. Most of its worldwide competitors have set up websites to solicit sales or disseminate information on their products. Manufacturer also realizes that a presence on the Internet may relieve some strain from its customer service and order entry operations and lead to unanticipated business opportunities. More critically, Manufacturer does not want to be left out of what has become the preferred way of doing business in the twenty-first century.

Manufacturer must first decide whether the website server should be located at Manufacturer's home office, at Offspring or elsewhere. It must ascertain what impact the website will have on Offspring's relationships with existing vendors and suppliers. The answers to these issues may turn on whether the website will be used to solicit sales or act merely as a source of information about Products and the addresses of local vendors.

Manufacturer decides to use its registered trademark as the domain name. Much to its dismay, it is informed that the domain name Product.com is

already in use. Manufacturer is concerned that its trademark is being infringed. Above all, Manufacturer wants to use its registered trademark in its domain name to preserve the continuity of its image and name recognition in the global marketplace.

Using an alternative domain name, Manufacturer designs a website that is at the forefront of technology. As anticipated, its customer base increases while the demands placed on its order entry and customer service departments decrease due to the self-service nature of the Web. Manufacturer then decides to immerse its global customers into an intense and interactive experience. Manufacturer accomplishes this by incorporating aspects of Home Country in its website together with examples of contemporary American culture, including a popular advertising jingle containing a trademark and slogan, a well-known song and various images of pop art. At the same time, Manufacturer commissions several artists to create an original jingle (lyrics and music) and artwork to be used in advertisements, packaging and on its website.

Unfortunately, recognition has its disadvantages. First, one of Manufacturer's competitors begins to use Manufacturer's jingle and artwork in its advertisements and website. Manufacturer is very concerned because this unauthorized use is creating confusion and misleading customers, and sales are being lost. To make matters worse, Manufacturer receives several letters from the owners of the art, music and advertising accusing Manufacturer of trademark infringement, copyright infringement and counterfeiting. Manufacturer is concerned about the legal ramifications of these charges, the damage to its reputation, and, most of all, the cost and expense of mounting a legal defense.

## **Operating Online**

Manufacturer advertises its website through various media both in Home Country and the U.S. Through its website, Manufacturer targets specific markets within the U.S. and solicits, advertises and ultimately distributes Products from its manufacturing facilities in Home Country. To maintain lower operating costs, contact with customers is conducted electronically with the exception of a toll-free number available to customers in several states. Much

to Manufacturer's alarm, a customer who resides in New York and who has regularly purchased Products from Manufacturer ("Customer") claims that the Product is defective and has caused him personal injury. Customer files suit in his home jurisdiction, the State of New York, against Manufacturer. Manufacturer has several concerns. Understandably, it is worried about the financial impact of the lawsuit and the effect on its reputation. Moreover, it is ill prepared to oppose a lawsuit in New York and questions not only the jurisdiction but also the applicability of U.S. law.

Soon thereafter, Manufacturer receives a large order for Products through its website. The order is valued at \$10,000. The purchaser, after navigating through Manufacturer's website and choosing his Products enters into a click wrap contract (explained below) with Manufacturer by clicking on an icon labeled "I Agree." Manufacturer ships the order to the purchaser, who returns it to Manufacturer claiming that it was ordered in error and that no contract exists. Manufacturer believes that when the purchaser entered into the click wrap agreement a legally binding contract was created. The purchaser does not agree, denies any knowledge of having entered into a contract and demands that Manufacturer produce a copy of the contract.

Legal issues Manufacturer faces when doing business on the Internet involve:

- Domain Name Disputes
- Corporate Tax
- Trademark and Copyright
- Litigation and Personal Jurisdiction
- Online Contracting
- Non-Solicited Email ("Spam")

## **Domain Name Disputes**

On January 1, 2000, the Uniform Domain Name Dispute Resolution Policy ("UDRP") became the governing policy used by Network Solutions, Inc. and other registrars of the .com, .net and .org domain names. Subsequently, ad-

ditional “top level” domains .biz, .info and .name have been added, which are also covered by the UDRP.

The UDRP is a system for handling disputes involving cybersquatters—those who register domain names using the trademarks of companies, or names of famous individuals, for the purpose of selling the domain names back to their rightful owners or other nefarious purposes. Under the UDRP, trademark owners may use administrative proceedings to resolve disputes based on “abusive registrations.” The administrative proceedings are faster and less costly than litigating domain name disputes. Non-cybersquatter disputes, however, continue to be handled through the court systems under traditional trademark law.

For trademark owners to prevail in the administrative proceedings, they must show that the cybersquatter’s domain name is identical or confusingly similar to the trademark owner’s mark. In addition, the domain name registrant must not have a legitimate interest in the domain name, and the domain name must have been registered and used in “bad faith.”

The critical task is proving “bad faith.” According to the UDRP, the following constitutes registration and use of a domain name in bad faith:

- (1) registration or acquisition of a domain name primarily for the purpose of selling, renting or otherwise transferring the domain name registration to the owner of the trademark, or a competitor of the trademark owner, for valuable consideration; or
- (2) registration of a domain name to prevent the owner of the trademark from reflecting the mark in a corresponding domain name, provided that the domain name registrant has engaged in a pattern of conduct; or
- (3) registration of a domain name primarily for the purpose of disrupting the business of a competitor; or
- (4) using a domain name to attract, for commercial gain, Internet users to a website or other online location, by creating a likelihood of confusion with the trademark of another.

If the trademark owner prevails at the administrative proceeding, the domain name will be cancelled or transferred to the trademark owner.

## Corporate Tax

The worldwide taxing community is reacting to changes in how companies do business internationally. Talks are now being conducted at the international level, and here in the U.S., to assess what changes in tax rules are needed to govern electronically generated commerce (to protect tax revenues) without interfering with the development of this dynamic electronic marketplace. In the international arena, it is likely that tax treaties will continue to be the vehicle through which tax policy will be brought in line with economic and administrative tax reality.

As portrayed in Stage III, Manufacturer chose to have a presence in the U.S., Offspring, that leads to taxation of its U.S. derived profits. The ongoing commercialization of the Internet may lead a future “Manufacturer” to conclude that it can access the U.S. market without a fixed presence, even if only initially, through an offshore website. The following are some possible choices Manufacturer may explore to take advantage of the Internet, and the potential tax results under existing rules:

- (i) Manufacturer may maintain its website on a server located in Home Country, and use it to disseminate information on Products and the location of major vendors throughout the world. It is unlikely that this activity would lead to Manufacturer being directly exposed to U.S. tax. This would likely be considered a passive use of the Internet without U.S. tax consequence.
- (ii) Manufacturer may expand its local website format to direct solicitation of sales of Products, with delivery from its own Home Country production. Assuming Offspring is not involved in Manufacturer’s Internet efforts, it is likely that Manufacturer will not, under the U.S. Model Tax Treaty, have a tax presence in the US, and its Internet generated sales income should escape U.S. tax.

- (iii) Manufacturer may continue to maintain a local website, but conclude that Offspring is in a better position to deliver and service Products sold to U.S. customers over Manufacturer's website. It is likely that the arrangement would be designed for Manufacturer to receive a commission for finding the sale, but that Offspring would in fact be the designated seller. Again, Manufacturer would likely, under the U.S. Model Tax Treaty, not have a sufficient presence in the U.S. to subject its profits (commissions) to U.S. tax. Under the U.S. Model Tax Treaty, the existence of a U.S. subsidiary, such as Offspring, would not by itself constitute such presence. Further, Offspring would not be acting in Manufacturer's name. In other words, an agency presence would not have been established, potentially giving rise to the requisite tax presence. The U.S. would carefully monitor the commissions paid by Offspring to Manufacturer to ensure that Offspring realized an arm's length profit on the Internet generated sales.
- (iv) Manufacturer may decide that it would be in its best interest to maintain a website located at Offspring to generate all U.S. sales. The server on which the website is located would be maintained in Offspring's home state. Offspring would clearly be subject to U.S. (federal) tax on its Internet generated profits. The issue here is whether Offspring would have state and local tax responsibilities beyond the state in which it maintains its physical operation and website. That is, will the website be viewed as a form of solicitation limiting its tax exposure to its home state, or will the states (individually or collectively) devise new rules to govern Internet generated revenues?

In these examples, we assumed that the server, through which sales are concluded, was located outside the U.S. or outside Offspring's home state. Were the opposite true, the tax results might be different. In fact, a thorough analysis of how the transaction is consummated would have to be made to assess contacts and potential U.S. tax presence. These are the types of issues the U.S. will be discussing with its treaty partners during the coming years.

## **Trademark and Copyright**

Protecting a company's copyrights and trademarks online must be a top priority for any business choosing to launch a website. Apart from making the traditional arrangements to obtain copyright and trademark registrations (discussed in the Appendix), businesses should have a U.S. attorney draft a legal disclaimer to be prominently displayed on its website. The disclaimer should, among other matters, put all users on notice that the trademarks and copyrights contained on the website are protected under U.S. copyright and trademark law. Copyright and trademark notices should be placed throughout the website itself. Efforts should also be made to police the Internet for trademark and copyright infringement by other websites.

Businesses should always consult an attorney before placing photographs, illustrations, artwork, music, logos or slogans on their websites. Since the Internet is often viewed as the unregulated "wild west", there is a growing temptation to use intellectual property owned by others. This impression is both false and hazardous. Through the ease of linking, framing and other means of appropriating the works of others through the Internet, a business can easily become the target of a copyright or trademark infringement lawsuit. If your company receives a "cease and desist" letter, such communications should be treated seriously and an attorney should be contacted for further action.

## **Litigation and Personal Jurisdiction**

Establishing a Web presence may subject businesses and individuals to litigation in courts throughout the U.S. Although a business may not physically operate in a particular locale, the nature of its website and related methods of operation can enable a court to exercise personal jurisdiction over the business itself. For example, lawsuits brought on theories of breach of contract, trademark and copyright infringement, unfair competition and a host of tortious acts are filed and litigated nationwide in connection with a nonresident defendant's website operations.

For a court to obtain personal jurisdiction over a nonresident defendant, it must first consider whether the defendant's actions satisfy the

requirements of a state's "long-arm" statute. These statutes differ from state to state, but usually provide for personal jurisdiction over nonresidents who either (i) transact business in the state, (ii) commit tortious acts in the state or (iii) commit tortious acts outside the state that result in injury within the state. If a state's long-arm statute is satisfied, courts will consider whether the Due Process clause of the Fourteenth Amendment of the U.S. Constitution is satisfied. The U.S. Supreme Court requires the presence of "minimum contacts" between a nonresident defendant and a state. In basic terms, the exercise of personal jurisdiction must not offend traditional notions of fair play and substantial justice.

As part of the analysis in a claim based on a defendant company's website, courts will consider whether the website is active or passive. Nonresident companies that operate "active" websites can expect to litigate lawsuits throughout the U.S. Conducting electronic commerce, including the formation and execution of online contracts, as well as offering high levels of interactivity through a website, may lead courts to characterize a company's website as "active." Providing goods and services over the Internet itself can also lead to personal jurisdiction over nonresident defendants. In contrast, operating a "passive" website usually will not confer personal jurisdiction. Passive websites merely contain advertisements or provide information about a company's operations. Because courts require the presence of "minimum contacts" between a nonresident defendant and a state to exercise jurisdiction, subjecting companies who run passive websites to personal jurisdiction would offend traditional notions of fair play and substantial justice, and thus run afoul of the U.S. Constitution. There is a spilt in courts over whether jurisdiction is proper over companies who operate an interactive site that allows visitors to conduct activities such as posting messages, purchasing books and/or making donations, which fall between "active" and "passive."

Some courts will also assess whether the company's out-of-state online activities had a foreseeable effect in another state, such that they should be subject to jurisdiction even though they are not conducting any business in the state. Courts have found the exercise of personal jurisdiction proper when the defendant company (1) directed electronic activity into the other

state, (2) with the intent of engaging in business or in another interaction within the state and (3) the activity created, in a person within the other state, a potential cause of action.

## **Online Contracting**

The Internet is not only a growing source of information and entertainment, but also a thriving arena for companies to extend their business operations by engaging in online commerce. Through the Internet, locally owned and operated businesses can reach both national and international markets and profit from new sources of income. Businesses can place catalogs, price lists and advertisements directly online. Online contracting can be accomplished through direct electronic mail communications as well as through contracts formed through an interactive website. There are three types of common online transactions: (i) clickwrap contracts, (ii) browsewrap contracts and (iii) shrinkwrap contracts. Clickwrap contracts exist when a purchaser visiting a seller's webpage decides to purchase an item and clicks a button indicating "I Accept" or "I Agree" after being presented with the opportunity to review the terms and conditions. The purchaser must "accept" or "agree to" the terms and conditions to complete the transaction. In recent years, courts have consistently held clickwrap contracts enforceable, primarily because the purchaser was presented with a clear opportunity to view the terms, and manifested their intent to be bound by clicking on the appropriate button. Browsewrap contracts exist when a purchaser visiting a seller's webpage decides to purchase an item and a link on the webpage permits them to view the contract terms, but they are never required to specifically click an "I Accept" or "I Agree" button to indicate their assent to the terms. Courts are divided on whether such contracts are enforceable because the purchaser never directly assents to the terms and never communicates such intent to the seller. The enforcement of such contracts is analogous to allowing silence to function as acceptance in traditional contracts doctrine. Courts consider several facts in deciding whether such contracts are enforceable, including, but not limited to: (1) the visibility of the link to the web page containing the

contract terms, (2) the frequency of use of the webpage by the purchaser and (3) whether the purchaser is a consumer or a business. Shrinkwrap contracts are formed after the online transaction; shrinkwrap refers to the terms and conditions that are enclosed with packaging after a person purchases goods on the Internet. Shrinkwrap contracts are generally contained in the box with the item purchased. Courts have held such contracts enforceable because they are generally sufficient to put the purchaser on notice of any terms and conditions. Purchasers are generally deemed to have assented to the terms and conditions if they fail to return the item or object to the terms and conditions in a timely manner.

Businesses should be aware of the applicability of the Uniform Commercial Code and the Statute of Frauds to the formation and enforcement of their online contracts. Contracts for the sale of goods valued at over \$500 must be in writing and signed by the party against whom enforcement is sought. The writing and signature requirements also apply to, among other matters, contracts that cannot be performed within one year and for the sale of land. The signature can be made in the form of an electronic symbol as long as the parties intend for such a symbol to authenticate the contract. Digital signatures can also be employed.

The enforceability of contracts formed through the Internet is a cutting-edge issue for the U.S. legal system, which is built on tradition and precedent. The laws that govern the formation and enforceability of contracts are also in a state of revision. For this reason, the parameters of conducting electronic commerce will assume greater definition in the not too distant future.

## **Non-Solicited Email (“Spam”)**

Any company doing business on the Internet is likely to use email. The ubiquitous problem of unsolicited email or “Spam” led to the passage in 2003 of the CAN-SPAM Act of 2003. This law was enacted to prevent and regulate unsolicited commercial email.

The law, which is enforced by the Federal Trade Commission (FTC) and the Department of Justice, pertains to any email of which the main purpose

is the advertising or promotion of a product or service, including the content of a website linked to an email. It does not pertain to email messages where a consumer has provided his or her contact information to a website and given them permission to send email; in the same light, emails regarding orders that customers have placed are exempt from the law.

The main requirements of the CAN-SPAM Act are:

- “To” and “From” fields in email must be accurate.
- “Subject” lines may not be deceptive.
- Recipients must be given a way to “opt-out” of future emails from the sender.
- Commercial email must be identified as an advertisement and include the sender’s physical postal address.

Every violation of these rules is punishable by fines.

# Epilogue

Due to its marketing skill, business sense and astute long-range planning, Manufacturer has created a highly successful, highly profitable U.S. operation. These financial rewards will raise questions of investment strategy amid tax planning. Manufacturer may consider making passive investments or investments in related businesses, or may enter unrelated fields. It is certain, however, that Manufacturer will face a complete new array of legal issues which, with proper planning and sound legal advice, can be turned into opportunities for success.



## Appendix:

### *Summaries of United States Laws*

# Corporate Tax

Tax law plays a significant role in planning to do business in the U.S. A foreign corporation must consider not only U.S. tax rules, but also home country rules on taxation of offshore earnings and offsets for U.S. taxes imposed on such earnings. The complexity and amount of U.S. tax depend on the extent of the activity conducted in the U.S. U.S. tax is imposed at the federal, state and local levels.

The federal government's tax base is net profits from businesses. States tax business income earned within their borders, as well as other activities and property within the state. For businesses operating in more than one state, the costs and administrative burden of state and local taxation can be formidable.

Outlined below are rules governing the taxation of income derived from the U.S. by a foreign entity doing business here, either directly or through a U.S. subsidiary. Note that the U.S. also taxes non-corporate entities that do business or earn income in the U.S., such as partnerships, trusts, etc.

## Limited Liability Company (LLC)

A partnership is a pass-through entity, with the tax on business operations being assessed against the partners (one level of tax). Under state law, investors (U.S. and foreign) can form a new type of U.S. investment vehicle which provides not only for limited shareholder liability, but also the possibility of being treated as a partnership for tax purposes. This entity is the "Limited

Liability Company” (LLC), whose characteristics are discussed in the Business Organizations section of this Appendix.

Under U.S. (federal) entity classification rules, an LLC will be treated as a partnership, unless the owners (at least two) elect to treat it as a corporation for tax purposes. A single member (owner) LLC will be disregarded absent an election to be treated as a separate corporate entity. In the case of a foreign corporate-owned LLC doing business in the US, this would result in the foreign owner having a branch in the U.S. For this reason, an LLC will probably not be the appropriate vehicle for a foreign corporation to do business in the US (see discussion of “U.S. Branch of a Foreign Corporation”, later in this summary). The states have, for the most part, adopted the federal classification of an LLC when applying their tax provisions.

## **U.S. Subsidiary**

The federal government taxes U.S. corporations on their worldwide income. Corporate profits are taxed at a graduated rate, with the top rate of 35% (note that tax rates may change after this guide is published.) A 30% withholding tax applies to passive income derived from a U.S. subsidiary, such as interest and royalties. Under U.S. tax treaties, the 30% withholding tax may be reduced or eliminated.

The principal tax issue confronting U.S. subsidiaries today is justifying to the U.S. that dealings with their foreign parents were conducted at “arm’s length.” U.S. tax law, like that of most developed countries, permits the reallocation of income and deductions among related parties to ensure that they have dealt at arm’s length. This rule is also found in U.S. tax treaties.

The U.S. requires annual filing of a corporate income tax return, to which a report is attached indicating the nature and dollar value of intercompany transactions. This informs the IRS of transactions to be reviewed on audit. More important, the U.S. subsidiary must maintain (and have the foreign parent maintain) records to support the arm’s length nature of the transaction. These records must be provided when requested, or the IRS may arbitrarily set the transfer price.

U.S. tax treaties allow the competent authority of the other treaty country to meet to resolve intercompany transaction control controversies that may give rise to double taxation. The U.S. has also adopted an advanced ruling procedure, whereby a U.S. company can negotiate an agreement, for a period of years, on an acceptable transfer pricing policy. For the advanced ruling procedure to work, the U.S. must convince the other interested country or countries to adopt the agreement.

## **U.S. Branch of a Foreign Corporation**

For foreign businesses with a U.S. branch, the U.S. taxes profits derived from the U.S. at the top rate of 30%. The U.S. also imposes a branch remittance tax on after-tax earnings of the U.S. branch that are deemed remitted to the foreign head office. The branch remittance tax is imposed at the same flat 30% withholding rate applied to dividends, but may be reduced or eliminated by treaty. Branch profits that escape this tax may still be subject to the 30% withholding tax when profits are distributed as a dividend, unless reduced or eliminated by treaty.

The principal tax issues faced by a foreign company operating through a branch are: determining, under U.S. tax concepts, the share of its profits attributable to the branch and avoiding the unintended application of the branch remittance tax. The U.S. also imposes a branch level tax on interest payments attributable to the U.S. operations, which can add an additional layer of complexity to operating in the U.S. through a branch.

The determination of how much income is attributable to the U.S. branch and the application of the branch remittance tax can be complex. Many foreign companies doing business in the U.S. have incorporated a U.S. subsidiary to avoid the problems associated with a branch.

Annual filing of a corporate income tax return is also required of the U.S. branch. If the foreign company has dealings with affiliated companies that impact the profit attributable to its U.S. branch, it must also justify that such dealings were at arm's length.

## State and Local Taxation

State and local governments tax profits from activity within their borders. State and local tax on business profits varies from state to state. Federal taxable income is generally the starting point in determining the tax to be assessed. State and local tax on profits is deductible in computing federal taxable income, but is generally added back to compute tax at the state and local levels.

If a business operates in more than one state, its income is usually allocated among the states using a formula based on property, sales and wages within and outside the various states. The apportionment factors and the relative weight assigned to a factor vary from state to state, as do tax rates. Thus, the state and local tax on profits can vary significantly depending on where the business has established a taxable presence.

Some states apply a “unitary” concept, in which the local business is required (or seeks) to combine its results with those of related companies to determine its tax base. California, for example, may seek to combine the results of operations of a foreign parent and its offshore affiliates with those of related U.S. companies doing business in California, absent a so-called “water’s edge” election to limit the unitary group to affiliated U.S. companies.

State and local governments impose other tax burdens on businesses. These include the duty to collect and remit sales and use taxes on sales to in-state customers, the collection of payroll taxes with respect to local employees, and taxes on property maintained within the state. The tax cost and administrative burden of state and local taxes are probably the fastest growing areas of tax concern in the U.S., and must be carefully considered.

## Exhibit to the Corporate Tax Summary

### Article 5

## US Model Tax Treaty

### Permanent Establishment

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “permanent establishment” includes especially

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop; and
- (f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or exploitation of natural resources, constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include

- (a) the use of facilities solely for the purposes of storage, display, or delivery of goods or merchandise belonging to the enterprise;
- (b) the maintenance of a stock of goods or merchandise belonging to

- the enterprise solely for the purpose of storage, display, or delivery;
- (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
  - (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
  - (e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
  - (f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs (a) to (e).

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

# Trademark and Copyright

## Trademark

U.S. trademark rights are created through use. The first to use a trademark on goods (or a service mark for services) sold in interstate commerce will generally enjoy the exclusive right to use the trademark on those goods. Registration with the U.S. Patent and Trademark Office is not necessary to establish trademark rights. However, registration provides significant benefits (such as a presumption of first use) and is strongly encouraged.

The first step in introducing a trademarked product into the U.S. is to determine whether the trademark is already in use. Disputes over trademark rights are usually resolved in favor of the first user, and it is wise to determine in advance whether anyone else is using the trademark. Trademark search firms provide a complete list of federal and state trademark registrations and additional information from computer databases.

Once the trademark has been cleared for use, the owner has several registration options. A foreign company that has registered the trademark at home may be entitled to a U.S. registration (known as a “Section 44(e)” registration) before using the trademark in the U.S. The owner must, however, have a good faith intention to use the trademark in the U.S.

Alternatively, the business may file an “intent-to-use” application. This application is available to individuals and businesses that have a good faith intention to use a trademark in the U.S., but have not yet sold products

bearing the trademark in the U.S. The intent-to-use application allows businesses to determine whether the Patent and Trademark Office will approve trademark applications before spending the money to bring new products to market. It can also give the applicant an early priority date and nationwide rights. However, unlike Section 44(e), a registration based on intent-to-use will not be issued unless the trademark is used on goods within a specified time after the application is approved.

The third registration method is based on actual use. It requires that the applicant has used the trademark on goods sold in interstate commerce as part of a legitimate sales effort, not a mere “token use.” Specimens of use must be submitted with certain information such as the date of first use.

Owners of U.S. trademarks must enforce their rights to avoid “abandonment.” Unauthorized use of the same or a confusingly similar trademark can lead to loss of trademark rights. Many U.S. trademark owners use “watch services” to discover potential infringements of their trademarks. Once an infringement is discovered, a “cease and desist” letter should be sent. In some cases it is necessary to sue for trademark infringement. If infringement is proven, the trademark owner may recover its damages, the infringer’s profits and, in certain circumstances, triple damages and attorneys’ fees.

Additional protections are available. A registered trademark may be recorded with U.S. Customs and Border Protection, which will exclude counterfeit and unauthorized genuine (gray market) goods from importation into the U.S. Such Customs protection may be limited, however, if the owner of the U.S. trademark is a foreign company or a U.S. company owned or controlled by a foreign company that owns the trademark outside the U.S.

## Copyright

U.S. copyright law has changed significantly in recent years. Prior to 1978, full copyright protection required many formalities, such as a copyright notice on all published copies of the work and registration with the U.S. Copyright Office. Failure to follow these requirements meant that the work went into the public domain.

Copyright formalities were eased by the 1976 Copyright Act (effective January 1, 1978). However, there remained the need for copyright notice and the requirement that the work be registered before an infringement lawsuit could be brought. These formalities prevented the U.S. from joining the most popular multinational copyright treaty: the Berne Convention.

Through legislation effective March 1989, the U.S. abandoned many of its copyright formalities, allowing it to join the Berne Convention. For works published after March 1989, copyright notice is not required, although it is still recommended. In addition, the requirement to register with the Copyright Office before a lawsuit can be brought now applies only to U.S. citizens.

To know the scope of U.S. copyright protection, one must know the date of first publication of the work (which determines the applicable law). In addition, for works first published outside the U.S., the author's nationality, place of first publication and the impact of copyright treaties must also be considered.

The following are points of interest concerning current U.S. copyright law:

- Copyright protection begins automatically upon creation of the work in tangible form and continues for seventy years after the death of the author or, for works created on behalf of an organization, ninety-five years after creation.
- Most creative expression is eligible for copyright protection, including writings, artwork, dramatic works, music and computer programs. To be protected, a work must be original and show at least a minimal level of creativity. Protection is not available for ideas, facts and processes, but is available for the expression of ideas, facts and processes.
- Damages for copyright infringement are the copyright owner's actual damages plus any additional profits of the infringer attributable to the infringement, or "statutory damages" (an amount set by the court within specific monetary guidelines).
- To protect authors and their families, many transfers of copyrighted works can be rescinded after a set period of time, despite contrary language in the transfer document.

- The purchase of an original work does not by itself convey ownership of the copyright in that work.

Another relatively recent change in US Copyright Law was the passage of the The Digital Millennium Copyright Act (“DMCA”). The DMCA was enacted in 1998 to specifically deal with copyright issues that pertain to the Internet.

One section of this law which is particularly important is the “Safe Harbor” provision. This law insulates companies that host content on the Internet from copyright infringement liability, if certain criteria are met. If a company allows users to post any type of content on its website, this provision should be followed to avoid liability. Second, if a web hosting service is found to be hosting material that is owned by your company, you must follow the guidelines in this law to have the content removed.

The spirit of this law is that Internet Service Providers, and other types of websites that host content that they do not review before it is posted on the Internet, should not be held responsible for copyright infringement, so long as they take action against the content if it is brought to their attention (so called “notice and take down”). Therefore, a U.S. lawyer should be consulted in order to fully comply with the numerous requirements of the DMCA.

Although the DMCA does not apply to trademark infringement (there is no safe harbor provision in the Lanham Act) numerous websites require “DMCA-like” notification when requesting removing of trademark infringing content from its site.

# Licensing and Distribution

A foreign company seeking to introduce its products into the U.S. will often consider three methods of distribution: sales agencies, distributorships and licenses. Brokers and manufacturers representatives may also be considered.

Sales agents locate buyers and solicit orders, which are usually accepted or rejected at the home office of the supplier. The agent does not take title to the goods. Rather, the agent receives a commission on orders accepted by the supplier. Sales agents often work on a small scale, allowing suppliers to gauge the demand for their products before establishing a local distribution network.

If the product is expected to sell well, a distributorship might be appropriate. A distributorship involves the sale of finished goods to a local distributor for resale. Distributors generally make a more elaborate marketing effort than sales agents, including advertising and promotional activities, participation in trade shows, showrooms, etc. In addition to the provisions found in most contracts, such as those covering representations and warranties, applicable law, confidentiality and indemnification, most distribution agreements cover the following:

- The products to be sold.
- The territory to be covered.
- Whether the rights will be exclusive or non-exclusive.
- The term of the distributorship.
- The price at which goods will be sold to the distributor, and the mechanics of shipment and payment.

- The distributor's obligation to use best efforts to promote and sell products.
- Provisions for advertising, promotion and other marketing activities by the distributor.
- The distributor's obligation to stock and service retail distribution points.
- The distributor's obligation to advise the supplier of trademark infringements that come to its attention.
- The distributor's obligation to comply with local rules and regulations, and to maintain general liability insurance naming the supplier as an insured party.
- Representations by the supplier concerning its U.S. trademark rights.
- The supplier's liability for product defects, and obligation to maintain product liability insurance naming the distributor as an insured party.
- Early termination rights based on breach, financial trouble, etc.
- Provisions for disposing of inventory after the distribution agreement ends, often involving the supplier's right to repurchase products at cost.

As sales grow, it may become more economical to manufacture products in the U.S. If the products bear a trademark that becomes well known, there might also be opportunities to sell different goods under the trademark. These situations call for a license.

A trademark license is a grant of rights to use a trademark in circumstances that would otherwise constitute trademark infringement. A license is required if the local business will manufacture, assemble, process or complete trademarked goods. No license is required for a distributor who merely resells finished goods.

The guiding principle of trademark licensing is quality control. Once the trademark owner establishes a reputation for a certain quality, it must control the quality of its licensees' goods to maintain that level. This supports the public's expectation of uniform quality of goods bearing the same trademark, and is essential for maintaining the trademark owner's rights.

Other than manufacturing rights and quality control provisions, license agreements are similar in many respects to distribution agreements. One difference involves the licensor's compensation, which is typically a royalty

based on net sales. Many licenses have minimum sales requirements and guaranteed minimum royalties. A licensee's use of a registered trademark establishes trademark rights for the licensor. This is true even if the first use of the trademark is made by the licensee. Sales of trademarked goods by a distributor also establish trademark rights for the supplier.

# Business Organizations

Establishing a business in the U.S. involves selecting the most advantageous type of business organization. Each type offers advantages and disadvantages that should be carefully weighed.

## Sole Proprietor

An individual trading in his own name is a “sole proprietor.” There are no formalities required to maintain this form of operation and the individual may unilaterally terminate the business at any time. The sole proprietor manages and receives all profits of the business, and has full liability for all business debts. Full liability is not advisable because it burdens the sole proprietor with all of the risk of loss.

## General Partnership

A general partnership is an association of two or more persons to carry on a business for profit. “Persons” includes both individuals and corporations, thus a corporation may be a member of a partnership. A general partnership can be formed with minimal formality and expense. In fact, formation of a general partnership requires no written agreement or governmental action. All that is required is that each partner manifests his or her consent to the formation of the general partnership. Each partner participates in management and has unlimited personal liability for partnership debts. In the absence of an

agreement otherwise, partners are jointly and severally liable, meaning that each partner can be liable for the full amount of the partnership debt. In the absence of an agreement otherwise, partners share the profits equally and bear the responsibility for losses equally, regardless of their capital contributions. Ordinary decisions can be made with a majority vote of the partners while extraordinary decisions require unanimity. Any transfer of a partnership interest dissolves the partnership.

## **Limited Partnership**

A limited partnership consists of one or more general partners (who manage the business and have unlimited joint and several liability for its debts), and one or more limited partners (who have no management authority and whose personal liability is limited to their capital contributions). General partners make ordinary decisions by majority vote but extraordinary decisions require a unanimous vote. A limited partnership is formed by filing a certificate of limited partnership with the secretary of the state in an applicable jurisdiction. A limited partnership has many attributes of a general partnership, with the added attraction of limited liability for the limited partners. To retain limited liability, a limited partner must not be active in the business or allow his name to appear in the partnership name. General partners may withdraw from the partnership at will but limited partners may not, and withdrawal does not trigger dissolution of the partnership.

## **Corporation**

A corporation is created pursuant to state statute. Corporations are legal entities, distinct from their stockholders (who provide capital and elect directors), directors (who make business decisions) and officers (who provide day-to-day management). Corporations can thus own property and assert legal rights. Corporations enjoy limited liability for stockholders, perpetual existence and free transferability of shares. They are reliable forms for raising capital from outside investors, offering flexible operation for those interested primarily in

profits rather than control. One disadvantage of the corporate form is double taxation. Corporations pay income tax on their profits and, when profits are distributed as dividends, stockholders pay personal income tax on the dividends. However, a corporation may, under certain circumstances, elect (under Subchapter S of the Internal Revenue Code) to have profits taxed only at the stockholder level. In order to make an election to be treated as an S corporation, the entity must not exceed a certain number of shareholders, the shareholders must be U.S. citizens or residents and there must only be one class of stock. If the corporation qualifies, the corporation pays no income tax on its profits and the shareholders pay income tax on their proportionate shares.

To preserve limited liability, the corporation must observe the “corporate formalities.” These involve holding regular meetings of stockholders and directors, authorizing corporate actions in the proper manner and having officers act in the corporate name, rather than in their individual capacities.

Selecting a state of incorporation is important, as the law of the state of incorporation governs the corporation’s internal affairs. A business may incorporate in any state, even if it does not do business there. The corporation statutes of New York and Delaware are generally considered favorable. Over half the “Fortune 500” companies are incorporated in Delaware, although few actually have offices there. There are companies that, for an annual fee, will serve as the registered agent for absent corporations, meaning they are designated on state forms to receive service of process in the event that the corporation is sued in its state of incorporation.

Corporations that do business in states other than their state of incorporation must “qualify” to do business in those states. To qualify, a corporation submits a written application and consents to the state’s jurisdiction for taxation and litigation. Activities that constitute “doing business” include maintaining an office or place of business in the state and other conduct that suggests to the public that the corporation is present in the state.

The name of the corporation must be available in the state of incorporation and in each state where the corporation will qualify to do business. Availability of a corporate name is determined by the Secretary of State, who will not allow two corporations to incorporate or qualify using the same or

confusingly similar names. A corporate name reservation is *not* the same as a federal or state trademark registration. Simply clearing a name with the Secretary of State will not insure that the corporation can use that name as a trademark for products.

Corporate existence begins when a certificate of incorporation is filed with the Secretary of State of the state of incorporation. The certificate must include (among other things) the name of the corporation, the purpose for which it is formed, designation of an agent for service of process and a statement of authorized capital stock. Many states allow significant optional provisions, including preemptive rights for stockholders and elimination of directors' and officers' liability in certain instances.

## **Limited Liability Company**

Like the corporation, the limited liability company (LLC) is an entity created pursuant to state statute. Its structure will be recognizable to those familiar with the Latin American *limitadas*, the German *GmbH* and the French *SARL*.

The LLC combines many desirable features of the general partnership, the limited partnership and the corporation to create an entity that enjoys both pass through tax treatment and limited liability for its owners (called members), without many of the restrictions imposed on Subchapter S corporations. The LLC also has considerable management flexibility in that its affairs may be managed either by its members or by separate managers appointed by the members for this purpose. Unlike limited partners in a limited partnership, members of an LLC may participate in management without forfeiting their limited liability and without the need for the equivalent of a general partner to have unlimited liability. In addition, there are no restrictions on foreign ownership of LLCs. Due, in part, to the explosive popularity of the LLC as a business form, the Internal Revenue Service has eliminated much of the uncertainty previously associated with the tax treatment of this entity by adopting the so-called "check-the-box" regulations. These regulations permit LLCs to choose pass through tax treatment without fear of being challenged. There remain, nevertheless, some unresolved issues involving the

tax treatment of LLCs, and businesses are encouraged to consult with a tax practitioner to ensure that their goals are compatible with the LLC form.

LLCs may be formed under the laws of any state, even if they do not do business there. The internal operations of LLCs are governed by the laws of the state in which they are formed. Some states' LLC laws are more flexible than others, with New York and Delaware considered favorable by many commentators. An LLC is formed by filing articles of organization with the state, and its internal affairs are governed by an operating agreement which serves essentially the same function as a partnership agreement. As in the case of other business entities, if the LLC does business in other states, it must file an application for authority in those states.

The LLC presents an option for foreign businesses locating in the U.S. that combines limited liability with pass through tax treatment. Although the lack of restrictions on foreign membership can make the LLC an appealing option, careful consultation with a tax practitioner is essential to ensure that the entity is compatible with the foreign business owner's goals and that its membership in the LLC will not subject it to undesirable U.S. tax consequences.

# Immigration

U.S. visa considerations require careful planning well in advance of travel, since processing times can be lengthy. Tax ramifications of the various visa options should also be considered.

The threshold issue when transferring employees is whether to pursue a nonimmigrant visa, immigrant visa, or both. Nonimmigrants come to the U.S. temporarily to carry on activities in accordance with the terms of a nonimmigrant visa. Immigrants enter the U.S. under an immigrant visa and reside here indefinitely in Lawful Permanent Resident status (evidenced by a “green card”).

In most cases, persons seeking to enter the U.S. are presumed to be intending immigrants. With limited exceptions, this means that nonimmigrants must prove to the U.S. Consulate and the Immigration Officer upon arrival that they have a temporary intent to remain in the U.S.

Some nonimmigrant visas require an approved visa petition from the United States Citizenship & Immigration Services (USCIS) before application can be made to the Consulate.

The following is an outline of the requirements of certain nonimmigrant and immigrant visas. Depending on the persons involved and the length of their projected stay in the U.S., visa requirements vary.

## Nonimmigrant Visas

B-1 Business visas are available to persons coming to the U.S. temporarily to conduct business on behalf of their foreign employer. They may not engage in local labor for hire, must be compensated by their foreign employer (expenses are permitted) and must maintain a permanent residence overseas which they have no intention of abandoning. B-1 visa holders may be admitted to the U.S. for an initial period commensurate with the purpose of entry up to a maximum of one year, with discretionary extensions of up to six months available under appropriate circumstances.

Business visitors from certain countries may apply for admission to the U.S. without a visa for up to ninety days under the Visa Waiver Program. Certain restrictions apply, including a prohibition against changing or extending visa status once in the U.S.

E Treaty visas can be submitted on behalf of Treaty Traders (E-1) or Treaty Investors (E-2), and are available to individual entrepreneurs or employees who are executives, managers or have “essential skills.” The visa holder and the applying company must be nationals of a country that has a Treaty of Friendship, Navigation and Commerce or similar agreement with the U.S. The nationality of a company is determined by the nationality of those who own more than 50% of the company. Public companies are presumed to be nationals of the place in which their stock is principally traded.

E-1 Treaty Trader requirements include an actual and substantial exchange of goods or services, and that over half of the total volume of trade conducted in the U.S. be between the U.S. and the treaty country.

E-2 Treaty Investor requirements include that the investment be substantial and expand job opportunities, and that funds be placed at risk and subject to loss.

E Treaty visas may be issued for a validity period of up to five years, depending on the nationality of the company. The initial period of admission is limited to two years, with possible extensions in increments of up to two years each.

Spouses and children under twenty-one are entitled to derivative E visas and derivative spouses of E visa holders are permitted to apply for U.S. work authorization.

H-3 visas are available for persons to come to the U.S. to receive training unavailable in their home country and who will return to work abroad following the conclusion of the training program.

J-1 Exchange visas are available to participants in an exchange program sponsored by an organization or institution designated by the U.S. Department of State. J-1 visas are commonly used by corporate organizations for training foreign personnel for up to eighteen months.

J-1 visas may subject the holder to a two-year home residence requirement, and carry special tax features under the Internal Revenue Code.

L-1 visas are available to intracompany transferees. The company must be doing business in the U.S. and at least one other country. The employee must have worked abroad for the overseas company for one full year in the last three years in an executive, managerial or specialized knowledge capacity. He must be transferred to a U.S. branch, parent, subsidiary or affiliate of the overseas company to work in an executive, managerial or specialized knowledge capacity.

Spouses and children under twenty-one are entitled to L-2 derivative visas. Spouses in L-2 derivative status are permitted to apply for U.S. work authorization. The visa is initially valid for up to three years. Extensions of stay for multinational executives and managers are available for a maximum of four additional years. However, extensions of stay for specialized knowledge professionals are available only for two years.

If the U.S. office has been doing business for less than one year, the L-1 visa is initially valid for only one year, but may be renewed for full validity if the U.S. business has sufficiently expanded.

H-1B visas are available to workers coming to the U.S. to be employed in a “specialty occupation.” The position in the U.S. generally must require a bachelor’s or higher degree (or its equivalent in employment experience) as the minimum entry level requirement. Spouses and children under twenty-one are entitled to H-4 derivative visas but are not authorized to work. The

visa is initially valid for up to three years, but extensions are available for an additional three years.

Before the H-1B visa can be applied for, the employer must file a Labor Condition Application (LCA) with the Department of Labor. The LCA form requires the employer to attest that:

- (i) H-1B nonimmigrants will be paid the required wage;
- (ii) employment of the H-1B nonimmigrant will not adversely affect the working conditions of workers similarly employed in the area of intended employment;
- (iii) as of the date of filing the LCA, there is no strike or lockout involving the position; and
- (iv) notice of the position has been provided to the bargaining representative or has been posted in a conspicuous place where the H-1B nonimmigrant will be employed.

To support these attestations, the employer must develop and maintain certain documents at the place of employment for up to one year after employment terminates.

## **Immigrant Visas**

Applications for immigrant visas (green cards) may be made to the U.S. Consul or the USCIS (circumstances permitting) by foreign personnel who:

- (i) have been classified in one or more of five employment based preference categories;
- (ii) where applicable, have obtained certification from the Department of Labor that there are no U.S. workers able, willing and qualified to do the job; and
- (iii) hold a priority date that has been reached on the immigration quota list.

One of the main employment-based immigrant visa preference categories for transferring foreign workers is Priority Workers. This category includes key managers and executives who have been employed outside the U.S. by a branch, parent, subsidiary or affiliate of the U.S. employer for one full year in the three years preceding entry.

Another category includes aliens of “exceptional ability” in the sciences, arts or business and advanced degree professionals. Advanced degree professionals must have a master’s degree or higher, or equivalent.

Professionals with bachelor’s degrees, skilled and unskilled workers are a third category. Skilled workers must fill positions requiring at least two years of experience. Unskilled worker classification is for positions requiring less than two years experience.

The employer must obtain Labor Certification from the Department of Labor before an immigrant visa petition can be filed; however, some categories, including Priority Workers, are exempt from this requirement.

The Labor Certification process is designed to ensure that there are no U.S. workers available to fill the job that the employer intends to offer to the alien. The employer must undertake a recruitment campaign to test the labor market before it is permitted to file an electronic application. When applicable, filing an application for Labor Certification establishes the alien’s priority date on the immigrant visa quota list.

## **Naturalization**

Immigrant visa holders may apply for naturalization to U.S. citizenship if they meet certain criteria. Before filing the naturalization application, the applicant (1) must have resided in the U.S. for five years as a permanent resident (three years if married to a U.S. citizen), (2) must have been present in the U.S. for at least two and one-half years of the residence period (one and one-half years if married to a U.S. citizen), (3) must have no breaks in the continuity of the permanent residence in the U.S., which generally means no absence from the U.S. of greater than 180 days, and (4) must have resided for at least three months in the local district in which the naturalization application is filed.

# Litigation

The U.S. is one of the most litigious societies of the world. This is unfortunate, as litigation can be an emotional and financially draining experience. Fortunately, litigation can often be avoided through proper long-range planning. Carefully drafted agreements can prevent disputes, and help insure success if litigation does result.

At times, litigation is unavoidable, and non-U.S. businesses should know what to expect. When contemplating litigation in the U.S., the non-U.S. entity should consider a number of factors. Cost cannot be overlooked. U.S. litigation is often expensive and time-consuming. Unlike most other countries, U.S. litigants (even the winning side) usually pay their own attorneys' fees. U.S. litigation also involves months and possibly years of discovery, in which documents are produced and depositions are taken. The rise in popularity of personal computers and e-mail as a method of communication has made document review even more arduous than it was a decade ago. If damages are modest, full-scale litigation may be impractical. Alternative dispute resolution (ADR) techniques such as arbitration or mediation may be attractive options. Indeed, many courts and industry groups mandate such ADR procedures in certain types of disputes. Additionally, it is common for parties to insert a mandatory ADR provision in contracts that provides that any dispute that arises from the contract will be submitted to ADR before a suit can be filed.

Another factor to consider in deciding whether to pursue a claim or whether to defend a claim is its strength. Cases can be summarily disposed

of if it appears that any one of the parties' claims cannot be sustained or there are no undisputed material facts. Summary judgment in the plaintiff's favor may be granted if no valid defense to the claim is apparent.

Another factor in deciding whether to litigate is the defendant's financial status. Often, obtaining a judgment is easy but enforcing it is difficult. Challenges in enforcing a judgment can occur when the defendant does not have significant assets, has hidden its assets or has no assets located within the jurisdiction of the deciding court. The goal in litigation is a meaningful, not a Pyrrhic, victory.

Where to sue is almost as important as whether to sue. U.S. litigation may be conducted in either federal or state courts. Although some cases are within the exclusive jurisdiction of one system (for example, bankruptcy cases can be heard only in federal court, while matrimonial cases are almost always a matter of state concern), a party may have a choice between the two depending upon whether the party or the subject matter of the suit satisfies certain criteria. If so, the choice of forum is a strategic decision made initially by the plaintiff's attorney on a case-by-case basis. However, a suit brought in state court may, under certain limited situations, be removed by a defendant to federal court.

Some considerations in deciding between a federal or a state forum are the quality of judges, the backlog of cases (a plaintiff normally wants to move a case along, while a defendant welcomes a delay), the scope of discovery, the remedies available in each court and the familiarity of the attorneys with the forum.

It is also common for parties to include forum selection clauses in contracts that provide that suit must be brought in a certain state and certain court (usually the place of business or state of incorporation of the party with superior bargaining power).

Once a lawsuit begins, the parties go through "discovery", a costly and time consuming process which sets U.S. litigation apart from litigation in most of the world. Discovery allows the parties to obtain evidence from each other and from third parties prior to trial. In both federal and state courts, this involves producing documents, taking depositions (oral testimony under

oath in response to an attorney's questions) and answering written questions called "interrogatories." Discovery may be lengthy. For example, the deposition of a key witness may last several days. Discovery has been the subject of much abuse in the past, which has moved many judges and legislatures to enact restrictions to cure some of these abuses.

After discovery is complete, the next step is the trial, although most cases settle before trial. Cases that are vigorously contested may take two or three years or more to come to trial. Even suits that move along quickly are rarely completed in less than eight months. With some exceptions, the parties may choose between a jury trial and a trial by a judge.

The trial verdict may not necessarily end the suit, as the losing party may have the right to appeal. An appeal is a request to a higher court to review the decision of the trial court. In most jurisdictions, a party is permitted one appeal. Permission is usually needed for further appeals. The cost of an appeal depends upon the nature of the case.

Once all appeals are resolved, the judgment becomes final. If the defendant has won, the suit is dismissed and cannot be brought again. If the plaintiff has won, the court will order the defendant to take (or refrain from taking) certain actions (an injunction), or enter a judgment for a certain amount of money damages. However, the value of any damage award depends on whether the defendant has assets to satisfy the judgment. Enforcement of the judgment is the responsibility of the party who has obtained it. That is done by locating the other party's assets and converting them to cash, often a difficult and time-consuming endeavor.

# Real Estate and Environmental Law

## Office and Warehouse Leases

To begin U.S. operations, the business will need office space for its employees and warehouse space for its products. It can either lease or purchase such space. In the beginning, when its needs may not be clear, it should probably lease. The first concern in leasing is to determine needs, including location, size, term and rent. The following should be noted, although as much real estate law is legislated on the state or local level, it is advisable to consult those regulations before entering a lease:

- A tenant should not pay rent until the landlord has substantially completed any work necessary to ready the premises for occupancy.
- Office leases, depending on the amount of space taken, generally have terms of three to twenty years. A tenant should seek all possible options from the landlord (additional space, longer term, etc.). A tenant in a favorable bargaining position can sometimes get an option to cancel the lease or give back space in the future.
- Assignment and sublet clauses should be carefully drafted to insure that if the tenant's needs change, the tenant would be able to assign or sublet all or part of the premises. The landlord's consent to an assignment or sublet should be "not unreasonably withheld or delayed."
- A tenant should seek as broad a "use" clause as possible. The use clause states how the tenant may use the premises. A narrow use clause could

frustrate the tenant's assignment and sublet rights.

- A tenant should understand the full cost of the lease. In addition to base rent, the tenant normally pays its share of increases in the building's operating expenses and real estate taxes. The tenant also usually pays for electricity and overtime heat, air conditioning and elevator service.
- The definitions of real estate taxes and operating expenses should be reviewed carefully. Base years used to calculate increases should never be earlier than the first full year of the lease.
- The landlord should make structural repairs to the premises and all repairs to the building. The tenant needs the right to make alterations to the premises. The tenant should seek a rent reduction if the landlord fails to make repairs or provide services.
- The landlord should give the tenant written notice of defaults. The tenant should have a chance to correct defaults before the landlord can exercise any remedies.
- A tenant should be sure to review the lease for the treatment of fixtures. Some landlords attempt to include language that any fixtures added by the tenant become part of the real property and cannot be removed by the tenant at the end of the lease.

The primary concern for warehouses, after size and price, is location. Issues such as construction to ready the space for occupancy, air conditioning, heat and elevator service and the tenant's right to make alterations are less important. Although simpler than an office lease, a warehouse lease contains many complex clauses and should be reviewed by an attorney.

## **Housing**

Once an office is opened in the U.S., non-U.S. employees will need housing. Unless they plan a long stay in the U.S., they should probably lease, rather than buy, residential property. Buying real property can be impractical if the property must be resold on short notice.

Employees who expect to be in the U.S. for a long time may wish to purchase a house, condominium or cooperative apartment. Historically, real estate has appreciated. In addition, unlike rent, real estate taxes and interest

on a residential mortgage may generally be deducted on the employee's U.S. income tax return.

Upon finding the right house or apartment, the buyer signs a contract of sale. One important clause is the mortgage contingency, which allows the buyer to cancel if he cannot obtain financing. Once the contract is signed, the buyer should order a title report and title insurance. The title report discloses encumbrances (mortgages, liens and easements), building violations and the amount of real estate taxes, water and sewer charges and other costs of owning the property. The title insurance policy insures the buyer against adverse claims of title.

Condominiums and cooperatives (co-ops) are generally apartments in a multi-unit building and are commonly found in urban, as opposed to rural, areas. The purchase of a condominium is similar to the purchase of a house. The condominium purchaser receives a deed and owns the apartment. The purchaser of a cooperative does not own the unit he occupies. Rather, he obtains a proprietary lease to occupy the apartment and shares of stock in the corporation that owns the building. Title reports and insurance are not required for cooperatives, which are personal property. A cooperative corporation has approval rights over prospective purchasers. A condominium board has only a right of first refusal.

Some common advantages of cooperative ownership in New York are lower prices than condominiums, no mortgage recording tax and no fees for title insurance. Some owners consider the resale approval requirements an advantage.

Advantages of condominium ownership in New York are higher resale value, lower common charges, no "master" mortgage on the building (no chance of legal problems with the master lender), and no arbitrary right to disapprove potential buyers. Some owners believe that the less restrictive resale rights are a significant advantage.

## **Manufacturing Plant**

To manufacture goods in the U.S., a business must buy, lease or “net lease” a plant and a warehouse. Our discussion of office leases applies generally to leases of manufacturing facilities.

A net lease is often used if the tenant will occupy the entire property. In addition to base rent, the tenant pays all taxes, insurance and charges for the property, makes all repairs and otherwise maintains the property. A business considering a net lease should discuss the income tax ramifications with its tax advisor.

Buying a commercial building is similar in many respects to buying residential property. The choice of location may be influenced by the availability of government grants or loan programs intended to attract new industry to particular areas. If financing is needed, the contract should list this as a condition to closing, similar to the mortgage contingency clause discussed earlier. The buyer should order a title report and obtain title insurance. Transferability of governmental permits, service contracts and other documents (such as leases) must be reviewed. Contracts to purchase commercial property should allow the buyer time to obtain financing and inspect the property (including environmental audits), and should give the buyer the right to cancel if there are building code violations that the seller does not correct.

## **Environmental Law**

When planning to buy or lease real estate in the U.S., all businesses must be aware of the broad environmental laws on the federal, state and local levels. Federal law, with certain exceptions, makes the current owner or operator of real property liable for any past (and present) releases of hazardous substances on the property, whether or not it was responsible for the release.

The extent of the environmental concern depends on the type of real estate. Most residential apartment leases do not present environmental issues. When leasing office space or warehouse space, however, the tenant should make the owner expressly responsible for compliance with all environmental

laws. A contract to purchase a commercial facility should include extensive environmental warranties by the seller. The contract should also give the buyer the right to conduct an environmental audit, with closing contingent on favorable audit results. Because the cost of cleaning up an environmentally deficient site can be staggering, the importance of environmental diligence cannot be overstated.

## **Tax and Government Incentive Considerations**

The desirability of any residential or commercial location will be influenced by the personal and business tax rates in the proposed state and/or city as compared to other competing locations. The desirability of commercial locations may further be influenced by the availability (or lack thereof) and amount of state and/or local government financial incentives to move to such location.

## Anticounterfeiting

Once a trademarked item becomes popular, it can become a target for counterfeiters. Counterfeiting is a form of trademark infringement, involving the intentional and knowing use of a “counterfeit” trademark on goods or services. A counterfeit trademark is an unauthorized trademark that is identical to, or substantially indistinguishable from, a federally registered trademark. Counterfeits are usually cheap imitations.

As with other types of trademark infringement, counterfeiting creates a likelihood of confusion between the genuine and non-genuine goods. When a counterfeit item is sold, a violation occurs even if the buyer knows the item is counterfeit.

Although a trademark owner receives some protection against “ordinary” infringement if the trademark is not registered, this is not true of counterfeiting. Most U.S. anticounterfeiting laws apply only to registered trademarks. For this reason, registration is a necessity for any trademark owner victimized by counterfeiting.

In the past, counterfeiting was addressed by civil law only. Since 1984, however, counterfeiting has been a criminal offense. Many trademark owners wage a vigorous private battle against counterfeiters, using private investigators and attorneys who specialize in this field.

There are a number of remedies against counterfeiters. Civil remedies include injunctions, seizure of counterfeit goods and destruction of goods after trial. Counterfeiting is treated more harshly under the law than other

types of infringement. For example, in ordinary civil infringement cases awards of money to trademark owners are subject to the court's discretion. In lawsuits involving counterfeiting, the court must award the greater of three times the counterfeiter's profits or three times the trademark owner's damages, plus reasonable attorneys' fees. Alternatively, a trademark owner may elect to recover statutory damages of not more than \$100,000 per counterfeit mark used or, if the court finds use of the counterfeit mark to be willful, not more than \$1,000,000 per counterfeit mark used. The court may also award prejudgment interest on damages. Criminal penalties include up to five years imprisonment and a \$250,000 fine for an individual first offender, and up to a \$1,000,000 fine for a corporate first offender. Second offenders face up to fifteen years imprisonment and a \$1,000,000 fine for an individual, and up to a \$5,000,000 fine for a corporation.

Counterfeit goods may be seized by U.S. Customs and Border Protection if the trademark owner has recorded the trademark with U.S. Customs. Such goods may be returned to the place of origin or allowed to enter the U.S. after the trademarks are removed. When counterfeit items are seized, they must either be destroyed or given to charity (after the trademarks are removed).

# Customs

When a foreign business imports products into the U.S., it will encounter the intricate rules of U.S. Customs and Border Protection. To avoid running afoul of these rules, and to take maximum advantage of opportunities for customs planning, it should consult a customs and international trade attorney at the earliest possible moment, even before beginning to manufacture.

Among the first customs issues that the importer will face are classification, valuation and marking. Classification involves assigning a classification number to imported goods based on the Harmonized Tariff Schedule of the United States (HTSUS). Among other things, the classification of goods determines the rate of duty the importer must pay. Frequently, goods may be described in more than one HTSUS category, presenting an opportunity to fashion merchandise to secure the lowest possible tariff. If these issues are considered early on, slight changes in the product could produce significant duty savings. Failure to investigate could be catastrophic, as U.S. Customs determines the classification and may assess at a rate far higher than anticipated long after the goods are sold.

Valuation is the determination of the value of imported goods for customs purposes. This value is the amount against which the tariff rate is applied. Most imported products are valued under the transaction value basis, meaning the price paid for the merchandise when sold for exportation to the US plus certain additional costs. Valuation is a complex area requiring expert advice.

Marking requirements must also be considered. Every foreign product imported into the U.S. must reach the “ultimate purchaser” marked with its country of origin, unless it is exempt. This presents a number of concerns, including who is the ultimate purchaser, where the marking should appear on the goods and what to do when components are manufactured in different countries.

Another possible area for customs planning involves the place of manufacture. Certain countries have trade agreements, treaties and programs with the U.S. that provide a preferential rate of duty. However, import quotas may apply to certain products coming from certain countries.

The importer must also be aware of the requirements of U.S. regulatory agencies. U.S. law requires that all imported goods meet the regulatory standards for domestic products. This requires familiarity with the rules of the Food and Drug Administration (FDA), Federal Trade Commission (FTC), Environmental Protection Agency (EPA), Consumer Product Safety Commission (CPSC) and other administrative agencies. These agencies’ rules (as well as others) are enforced by U.S. Customs, and failure to comply may result in delay, detention or seizure of shipments by U.S. Customs.

Some importers may be confused by the difference between customs brokers and customs attorneys. Customs brokers assist importers in “clearing” goods through U.S. Customs formalities. The more sophisticated issues of classification, valuation and marking, as well as the planning opportunities described above, are addressed by the customs and international trade attorney.

Other services available from qualified customs and international trade attorneys are: administrative and judicial protests of the government’s determination of value, classification, duty and other issues; assistance with U.S. Customs investigations and audits; and advice in other specialized areas. Such areas include “drawback” (a refund of 99% of duties and taxes paid on imported merchandise); countervailing duties (duties assessed to counter the effects of subsidies provided by foreign governments to merchandise that is exported to the U.S.); anti-dumping duties (duties assessed on imported goods sold in the U.S. at less than fair value); relief from liquidated damage claims and penalties; and the use of bonded warehouses and foreign trade zones.

# Antitrust

There are two sources of U.S. antitrust law: federal law, consisting principally of the Sherman Act and the Clayton Act (there are other statutes as well, such as the Federal Trade Commission Act), and state antitrust laws, which are generally modeled on the federal statutes.

Federal and state antitrust laws prohibit unreasonable restraints of trade. Although many business practices (such as exclusive distribution agreements) restrain trade, generally only those practices that impose unreasonable restraints violate the antitrust laws. This is known as the “Rule of Reason.” Certain vertical restraints, such as a manufacturer’s requirement that a distributor sell only in a limited area, or an exclusive distributorship in which the distributor agrees not to carry products of his supplier’s competitors, are analyzed under the rule of reason. It is often difficult to demonstrate an unreasonable effect on competition. Consequently, defendants are often successful when a challenged practice is analyzed under the rule of reason.

With two major exceptions, antitrust laws are violated only when two or more parties engage in a combination or conspiracy to restrain trade. Unilateral conduct will generally not be condemned. The exceptions to this rule are when a business monopolizes the market for a given product or service, or attempts to do so. Because a combination of parties is essential for an antitrust violation, a manufacturer can choose on its own to sell to whomever it wishes. Subject to the Rule of Reason, it may be legal for a manufacturer to suggest or dictate the price at which a distributor should resell products, and

to refuse to sell to any distributor that does not sell at the indicated price.

The fine line between unilateral (legal) conduct and an illegal combination is often at issue when a manufacturer terminates a discounter who is under-selling the manufacturer's other distributors. Often, the decision to terminate is made in response to complaints from the higher-priced distributors. Although it might appear that there is an agreement between the manufacturer and the complaining distributors to terminate the discounter, Supreme Court decisions in the 1980's made it extremely difficult for discounters to prove an unlawful combination.

Antitrust litigation is usually complex, time-consuming and expensive. However, the availability of triple damages and attorneys' fees under federal and many state antitrust statutes (such as New York's) causes many cases that might otherwise be settled to be litigated. Triple damages and attorneys' fees mean that even the threat of antitrust litigation must be taken seriously.

# Employment

In the U.S., there is no right to a job or continued employment once hired. In most jurisdictions the rule is that, absent an employment contract, employment is “at will.” This means that the employee is free to leave at any time, and the employer may end the employment at any time, without cause and without notice.

There are exceptions to employment at will. Federal, state and local laws (such as New York City’s Administrative Code) prohibit discrimination based on race, religion, sex (some laws also protect sexual orientation), national origin and age. The Americans with Disabilities Act provides broad protection to the disabled. These laws also protect employees from discrimination in the terms of their employment, such as promotions and salary adjustments. A company entering the U.S. must be aware of all discrimination laws in the jurisdictions in which its business will be located.

In addition, an employer cannot discharge an employee in violation of public policy. For example, “whistleblowers” who are fired after reporting employer wrongdoing have recovered damages for wrongful discharge. Also, although a formal contract may not exist, some courts have held that a company policy manual can create an implied contract that limits the employer’s right to terminate. An employer with a policy manual may be able to terminate only for cause, rather than for any non-discriminatory reason. A policy manual should state clearly that it is not intended to create any contractual liability, and that the employer reserves the right to terminate at will.

In general, employers are not legally required to provide specific employee benefits. One exception is that certain employees are entitled to minimum wages and overtime under the Fair Labor Standards Act and state's laws, for working in excess of forty hours a week. Certain benefits are commonly given. Vacation and severance pay, health and life insurance and pension and profit-sharing plans are some of the benefits an employer may wish to provide. Leave to care for a newborn or sick family member is required in some states, and may also be required by federal family leave legislation.

Employees are frequently asked to sign "restrictive covenants." A restrictive covenant is an agreement by an employee not to compete with the employer after leaving the company. To be enforceable, the covenant must be reasonable in scope, duration and geographic area. A restrictive covenant will probably be unenforceable if it bars competition for an unreasonably long period, or restricts activities in areas in which the employer does not do business. Restrictive covenants are illegal under some local laws and may also be unenforceable for other reasons as well, such as the public's need for a particular service (restrictions on doctors and lawyers have been stricken on this ground).

Restricting employees' use and disclosure of trade secrets and confidential information may be another important concern. Although employees are under a general duty not to disclose trade secrets or confidential information, or to use such information for their own benefit, employers often require that employees sign confidentiality agreements. These agreements, like restrictive covenants, are analyzed for reasonableness. Courts judge whether the employer's information should be protected (for example, customer lists are often not protected), and whether the agreement protects the employer's interests without being unduly burdensome. The duration of the agreement is often an issue. In cases involving disclosure of secret technology, courts often prevent disclosure only for as long as it would take another business to discover the technology through reverse engineering.

Drug testing has been a controversial issue in employment law over the past decade. While a great deal of attention has been given to governmental drug testing, private testing has become more common. While some states and mu-

icipalities have laws regulating private drug testing, most do not. Most states do not include current drug use as a disability under their discrimination laws. The Americans with Disabilities Act follows this rule. However, recovered drug users and those enrolled in rehabilitation programs are considered disabled and are protected from discrimination. Proposed federal legislation governing when and how drug testing can be conducted has yet to be passed.

An employer who tests employees for drug use may face common law tort liability. For example, the California Supreme Court has held that an overly intrusive drug test may be an invasion of privacy. As private testing becomes common, employers should expect more challenges under a variety of common law theories.

# Deferred Compensation and Retirement Plans

There are several types of deferred compensation and retirement plans each with technical requirements, advantages and disadvantages. Most plans are regulated by the federal government under the Employee Retirement Income Security Act of 1974 (ERISA). ERISA sets strict requirements for employers. However, within the bounds of ERISA, plans can be structured in many ways.

The first question is whether the plan is “qualified” or non-qualified.” A qualified plan entitles the employer to certain tax advantages if the plan is set up and administered under the rules of the IRS. A non-qualified plan does not enjoy such tax benefits. The major tax benefit to being qualified is that the employer can take a tax deduction for contributions to the plan immediately, while employees are not taxed until they actually receive benefits. A disadvantage of a qualified plan is that to secure such favorable tax treatment the plan must generally cover a broad portion of the work force, including many lower-paid employees that the employer might not want to cover.

For a non-qualified plan, the employer may not take a tax deduction for plan contributions until the benefit is paid to employees. Despite this disadvantage, a non-qualified plan is sometimes more advantageous than a qualified plan. For example, a non-qualified plan may secure the services of a valued executive for several years. The employer would enter into a

deferred compensation agreement with the employee with a vesting schedule for benefits (benefits accrue to the employee only if he is still employed by the company at a future date). These plans are often referred to as “golden-handcuff” plans, due to the financial penalty the employee incurs by leaving before benefits vest. Benefits in non-qualified plans are often informally funded through corporate-owned life insurance policies on executives in the plan or through one of several types of trusts.

It is important to note, though, that the American Jobs Creation Act of 2004 significantly altered the regulation of non-qualified deferred compensation plans. While non-qualified plans remain important tools for employers, care should be exercised when drafting such plans to account for the new legislative changes. Furthermore, the new changes may also impact employees sent from another country to work in the U.S. Care should be taken to review any U.S. deferred compensation plans before implementation as well as any home country bonus or deferred compensation plans in which the inbound employee will participate so as to avoid the possibility of significant penalties associated with failing to comply with the new regulations (commonly known as “Section 409A”).

Plans can be “contributory” or “non-contributory.” A contributory plan may be funded by both employer and employee contributions. In non-contributory plans, all funds are contributed by the employer. Most plans are non-contributory.

Plans can also be “funded” or “unfunded.” The golden-handcuff non-qualified plan (explained above) is an example of an unfunded plan. Certain “excess benefit plans” may also be unfunded. ERISA requires that almost all other employee pension plans (including all qualified pension, profit-sharing, salary deferral and stock bonus plans) be funded. For a plan to be funded, the money accumulated to pay future benefits must be held in a separate trust account to protect employees’ benefits.

There are four main categories of qualified funded plans:

## **Defined Benefit Pension Plan**

In a defined benefit pension plan, the employer pays benefits to employees (or their beneficiaries) after retirement. The employer pays stated benefits, normally for life. No separate account is maintained for each employee, since the amount he will receive is pre-determined. The employer's contributions to the plan are actuarially determined to fund future benefits. These contributions must be made regardless of the company's profitability (or loss) for the year in question.

## **Defined Contribution Plan**

A major difference between a defined contribution plan and a defined benefit plan is that the employer's annual contributions to a defined contribution plan are generally not mandatory. Typically, the employer makes a discretionary payment out of net income to a trust fund for employees. In loss or low profit years, the contribution can be skipped. Unlike a pension plan, amounts contributed to a profit-sharing plan are held in a special account for each employee. Benefits for each employee are based on the amount in his/her special account at retirement.

## **Stock Bonus Plan**

A qualified stock bonus plan is a derivative of the profit-sharing plan. Instead of cash, employees receive stock. The most common example is the Employee Stock Ownership Plan (ESOP). ESOPs also provide a market for shares of closely held corporations and a possible source of funding for the corporation.

## **Salary Deferral Plan**

A salary deferral (401K) plan allows employees to contribute part of their salary to the plan on a tax-deferred basis. These plans are very popular in the U.S. Employees' taxable income is reduced by their contributions, which

grow tax-free in the plan accounts. Strict requirements ensure that salary deferral plans do not discriminate in favor of highly paid employees. The most common incentive for lower-paid employees to contribute to a salary deferral plan is an employer matching program incorporated into the plan that is operated in conjunction with the employee's salary deferral. Under this arrangement, employees' contributions to the salary deferral plan are matched with contributions by the employer.

# Estate Planning

U.S. estate tax can have a significant financial impact on an employee's family. Estate planning is therefore an important concern for business people transferring to the U.S.

For estate planning and tax purposes, there is an important distinction between U.S. domiciliaries and non-domiciliaries. Estate tax for domiciliaries is based on the value of worldwide assets. Non-domiciliaries are taxed only on U.S. assets. These taxes, which range from 18% to 45%, are based on the total value of assets transferred. However, if the state of residence has its own estate tax, the effective rate of tax may be higher.

For "domicile" to be acquired in the U.S., an individual must live here, with no definite present intention of leaving. Without the intention to remain in the U.S., even U.S. residence for income tax purposes will not constitute domicile.

Factors that indicate an intention to remain in the U.S. are the location of the individual's family, home and other assets; his visa status; clubs and organizations he belongs to; and where he voted and filed tax returns. Intent can also be shown by how a person positions his assets, and by provisions in employment contracts, wills and trusts. Further, even if a person is domiciled in the U.S. and another country, an estate tax treaty with the country of original domicile may provide rules for determining domicile.

The U.S. requires financial disclosure by both domiciliaries and non-domiciliaries. Domiciliaries must disclose and are taxed on worldwide assets.

Non-domiciliaries who wish to deduct expenses allocated totally or partially to U.S. property must also disclose worldwide assets.

Estate tax rates depend on whether a person is a U.S. domiciliary or non-domiciliary. Estates of U.S. domiciliaries valued at \$2,000,000 or less are not subject to federal tax (although the threshold for state tax can be lower). Estates of non-domiciliaries are taxed only on property within the US exceeding \$60,000.

Taxable assets include those held in the decedent's name (or jointly with a spouse), life insurance and pension benefits. Assets held jointly with a non-spouse are presumed to be owned exclusively by the decedent, unless separate contributions toward the purchase are shown.

One way to reduce estate tax is through the "marital deduction." Since 1981, the U.S. has allowed unlimited amounts of wealth to be transferred to surviving spouses without tax. However, under the tax legislation enacted in 1988, no marital deduction is allowed if the surviving spouse is not a U.S. citizen. Estate tax can be deferred for transfers to non-citizens spouses, however, if the assets are put in a U.S. trust for the benefit of the surviving spouse. The trust must have U.S. trustees and, when the surviving spouse dies or the principal is distributed from the trust, assets will be subject to U.S. estate tax.

An alternative to putting all the employee's assets in a U.S. trust for his or her spouse is to transfer assets to the spouse prior to death. U.S. domiciliaries may transfer up to \$125,000 per year to non-U.S. citizen spouses without a U.S. gift tax. U.S. gift tax rules do not apply if spouses enter the U.S. with their assets already divided.

Nine months after death, an estate tax return must be filed with payment of tax. The period of estate administration generally lasts until the IRS audits the return. This can take six to nine months after the return is filed.

Note that the future of U.S. estate tax is uncertain. The estate tax is set to expire in 2010, but then to return in 2011 with the rates that were in effect in 2001. Most commentators believe legislation will occur which will exempt estates valued at less than \$2,000,000 or perhaps \$3,000,000 from the estate tax. However, at the time of publication, no significant developments have occurred which definitively forecast the direction any future legislation will take.

