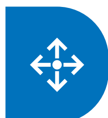
U.S. tax guide

U.S. expansion considerations for European corporations

Expanding into new markets is the obvious next step for growing businesses in Europe. A European corporation is naturally drawn to the U.S. market when it decides to expand its operations internationally. The United States offers a business-friendly environment, a substantial consumer base, and potential local incentives.

Expansion structure

How a European organization expands into the United States will depend on its organization, industry, regulatory framework, and supply chain. Based on the business model, a decision needs to be made on whether an existing European legal entity will engage with U.S. customers directly or through a separate U.S. legal entity.



Proper vehicle for expansion

When U.S. activities are expected to be extensive, a European corporation will often establish a wholly owned U.S. subsidiary, as either a limited liability company (LLC) or a corporation, to house the U.S. activities and shield the European corporation from U.S. legal, commercial, and tax liabilities. Structuring U.S. investments becomes more complicated when the U.S. presence is expected to be limited. Engaging U.S. customers directly through the European corporation may save costs, but its activities in the United States may expose the European corporation to U.S. tax liabilities and filing obligations.

To help European corporations make such decisions, below is an overview of the potentially relevant U.S. tax regimes.

Income taxes

Taxation of non-U.S. corporations. A European corporation whose activities are extensive enough to establish a "U.S. trade or business" is generally taxed on a net basis (i.e., certain deductions allowed) at a federal rate of 21 percent on income that is effectively connected with such U.S. trade or business. In addition, profits deemed or actually repatriated to the European corporation and not reinvested in the U.S. business may be subject to branch profits tax (a deemed dividend concept) at 30 percent (subject to potential treaty reduction).

The United States has an extensive income tax treaty network. To the extent a treaty exists between the United States and the foreign corporation's home country and the foreign corporation meets certain substantive requirements set forth in the relevant treaty, withholding tax (as described below) or branch profits tax may be reduced or eliminated. Furthermore, a European corporation that is entitled to treaty benefits may be afforded more latitude with respect to the activities that it (or its agents) can undertake without creating a permanent establishment and becoming subject to corporate income tax.

Establishing a U.S. subsidiary. Establishing a U.S. subsidiary generally provides greater flexibility for U.S. operations than direct investment, by allowing for a wider range of funding and intercompany arrangements. Profits earned by the U.S. subsidiary would be generally subject to the 21 percent federal rate (and applicable state and local tax), but the subsidiary could avail itself of certain incentive regimes not available to a non-U.S. corporation. Passive income such as dividends, royalties, and interest paid by

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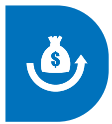
a U.S. subsidiary to its European parent is subject to a statutory withholding tax of 30 percent but is commonly reduced to 5 percent or zero as the result of the extensive U.S.-European treaty network.

State and local tax. In addition to income tax at the federal level, individual states and localities may also impose a tax on income. This tax is generally imposed based on physical nexus or other substantial connections with the state, such as economic nexus. In some cases, merely having a substantial customer base in a state may be enough to generate economic nexus. State corporate income tax rates are independently established by each state, varying from 0 percent to 12 percent.



Indirect taxes

The United States does not impose a federal-level value-added tax or sales tax, although certain businesses may be subject to industry-specific excise taxes. State and local governments often, however, do impose indirect taxes such as sales and use taxes, franchise taxes, and property taxes. These might be imposed directly on a foreign corporation or the taxing authority may require the seller to collect taxes from the purchaser. Altogether, these levies can represent a significant cost of doing business in the United States.

Funding

A European corporation may find it beneficial to fund its investment in the U.S. subsidiary through a mix of debt and equity. The precise split between the two, and the terms of the debt, should be determined via a debt capacity and transfer pricing study. Interest paid on intercompany loans may be deductible subject to certain limitations.

Transfer pricing

Establishing a U.S. subsidiary provides the ability to put in place intercompany arrangements such as licenses and service contracts. U.S. transfer pricing rules focus on whether payments made between related parties (e.g., companies with common ownership) are at arm's length (i.e., fair price between unrelated persons). A transfer pricing study is recommended for European companies with payments made to or from a U.S. subsidiary, to establish that the rates charged between the two parties are at arm's length.

Credits and incentives

Many states offer tax benefits for investing in businesses, particularly for local manufacturing activities, such as tax credits and incentives for business investment (e.g., jobs credits, training credits, and negotiated incentives).

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Employer-level taxes

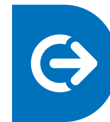
From a corporate perspective, the United States imposes payroll taxes, including Social Security taxes and unemployment insurance taxes, on employers. Additionally, an employer is generally required to withhold the employee's portion of its employment tax liability from the employee's salary.

Tax reporting requirements

In today's environment, it is increasingly important for multinational companies to comply with local tax reporting requirements to demonstrate that requisite governance and internal controls are in place.

Trade and customs

Increasing global trade volumes together with the complex supply chains create significant challenges for global companies to manage import and export costs and compliance obligations. Imported goods into the United States are subject to customs entry requirements. These goods must be "classified" according to the Harmonized Tariff Schedule of the United States as dutiable or duty-free. U.S. law requires the importer or its legal agent to file documents with the U.S. Customs and Border Protection, including the declared value, quantity, classification, and origin of the merchandise. Exported goods from the United States are not subject to U.S. taxes or duties; however, the United States imposes various export control laws on exported goods that are intended to protect its national security interests and foreign policy objectives. The export control laws regulate the shipment or transfer of controlled items, software, technology, or services out of the United States, or to non-U.S. persons.



Exit considerations

A European corporation should consider the administrative process and cost associated with selling or terminating the U.S. operations. Generally, capital gains derived by a European corporation arising from a direct sale of a U.S. subsidiary should not be subject to U.S. tax to the extent that U.S. subsidiary does not hold a substantial amount of U.S. real property. Conversely, any gain recognized by a European corporation on the sale of assets used in a U.S. trade or business (including via the sale of interests in a U.S. subsidiary that is not taxed as a corporation) would generally be subject to tax at the rate of 21 percent at the federal tax level.

How KPMG can help

KPMG in the United States has a London-based group of 40 U.S. Tax professionals who can serve as the first point of contact for your expansion needs. In addition to collaborating with stateside professionals, the London team works closely with local country professionals throughout the KPMG global organization of member firms to provide European clients with a range of tax services, including initial expansion planning, ongoing compliance, and exit support.

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