

LAW OFFICES OF
MARC REDLICH

ONE STATE STREET, 15TH FLOOR
BOSTON, MA 02109

t +1 617.720.0900

f +1 617.720.0987

e general@redlichlaw.net

w redlichlaw.net

GUIDE TO DOING BUSINESS IN THE UNITED STATES

The United States is a huge economic market by almost any measure of financial activity, including manufacture, agriculture, mining, purchase and sale of products, import, high-tech, bioresearch, finance, and the public securities markets. Although the U.S. suffered a severe recession beginning in late 2008, it has recovered substantially in terms of productivity, the stock market and other indices of growth. The unemployment rate has been reduced to pre-2008 levels (under 6%), although there are still more people unemployed or underemployed, in terms of their education, training and job skills. There is still a plentiful labor force available throughout the U.S.

Structure of Government and Legal System

The structure of government in the United States is of a federal nature. The U.S. Constitution makes Federal law legislated in Washington, D.C., supreme in most regards. However, the 50 States share in legislating on a local basis including employment law, wage laws, structuring business entities, education, general administration of business, and health and safety within each State. The Federal government also has departments of, *e.g.*, Education, Health and Human Services (“HHS”), and provides an umbrella and very importantly, vast amounts of financing to the States in many areas in which the States share authority. On the other hand, the Federal government has exclusive jurisdiction over certain areas such as foreign affairs, defense and immigration. I will touch upon some of the areas in which Federal and State jurisdictions overlap in the discussion below. The factor to keep in mind is that when doing business in the U.S., individuals and business entities may very well find themselves subject to both Federal and State laws which are complementary and overlapping. Income taxes are levied on both the Federal and State levels, and in some cases, like New York City, there is a city income tax as well. Many, but not all the States, also levy a sales tax on personal property purchased by consumers. There is no VAT, as in Europe, and different states will tax the sale of some items but not others – or none at all.

The Court Systems

Federal and State governments each have their own court systems. These generally go, in the States, from lower courts, with or without juries, to the general jury trial courts (often referred to as Superior Courts or Courts of Common Pleas depending on the State), to intermediate Appellate Courts, and finally to each State's Supreme Court. New York State terms its general jurisdiction trial courts as their Supreme Courts and their highest court The Court of Appeals. Massachusetts refers to its highest court as the "Supreme Judicial Court" to distinguish it from the State legislature or "Great and General Court".

The Federal Courts include the District Courts – trial courts - located in each State. They are sometimes divided into geographical divisions (*e.g.*, "U.S.D.C. Mass, Western Division", or the District Court for the Southern District of New York ("SDNY")). Decisions in those courts are appealable to the eleven U.S. Courts of Appeal which sit around the country. Each Court of Appeal reviews appeals from the Federal District Courts in the several states within its jurisdiction. The Supreme Court of the United States reviews decisions by writ of *certiorari* from the eleven Courts of Appeal and from all of the States' highest courts. With few exceptions (such as disputes between the States), the Supreme Court chooses what cases it wants to hear based on criteria that have been developed over the last two centuries.

Not every plaintiff can file suit in a Federal District Court. The cases that are allowed to be filed are those in which a "federal question" is raised or where there is "diversity of citizenship" (the group of plaintiffs and the group of defendants are from different states, with no overlap), with a minimum expectation of damages of at least \$75,000. All other cases may be filed in the State courts. There are also situations where a defendant in a State court action can "remove" the case to Federal Court if certain criteria are met, *viz.*, if (1) there is a federal question raised, or (2) if there is "diversity of citizenship", a minimum of \$75,000 at stake and where all defendants are from a state other than the one in which the plaintiff has commenced suit).

The U.S. Bankruptcy Courts also sit in each District Court venue. The States also have laws covering insolvency and receivership, and the debtor or its creditors may at least initially choose which path to follow.

Business Organizations

Very few business entities qualify for a Federal type of business organization. Examples are national banks and quasi-governmental organizations. Most businesses are organized under the various States' laws. The ways to do business in Massachusetts, for instance include:

1. Sole proprietorship. This is available for anyone doing business on his or her own. In some States one is required to register the sole proprietorship with a local agency, in our case, the City or Town Clerk's office. The owner is personally liable for all debts of his/her company, *i.e.*, unlimited liability and reports all of the income and expenses on his or her individual income tax returns.
2. Partnership. A general partnership exists where two or more people conduct a business together. It can arise either from a written agreement or by a course of doing business. Under Federal law and in most States, the individual partners are taxed on their *pro rata* share of the partnership's profits, whether they are distributed or retained by the entity. As with a sole proprietorship, the partners are fully responsible for the debts of the general partnership.
3. Limited Partnership. This is a form of investment vehicle often used for real estate developments. A General Partner manages the business and limited partners invest in the venture. The limited partners generally take no role in the operation of the business, but rather, are passive investors. In this vehicle, the Managing Partner is liable for the LP's debts, but not the limited partners. The individual partners are taxed on their share of the partnership's profits according to their "interest" in the partnership, whether or not distributed
4. C-Corporation. This is the classic type of corporation, from General Motors on down to small family businesses. The investors purchase shares of stock in various amounts. A C-corporation is taxed at the corporate tax rate established by the Federal and/or State governments. Investors pay taxes only on the distributions or dividends paid to them by the corporation. Any distributions are required to be pro rata according to the terms of the

share class. Different classes of shares can have a preference as to distributions of income or upon liquidation. The key benefit of incorporation is “limited liability”, *i.e.*, the investors and shareholders cannot be sued by creditors; only the amount they have invested in the corporation is at risk. Non-U.S. citizens and companies can be shareholders in a C-Corporation.

5. S–Corporation. This is a Federal tax variant of the C-corporation. It was established in the 1950’s in order to allow investors to obtain the benefit of limited liability afforded by incorporating, and also to provide that the profits or losses of the entity are “passed through” to the stockholders for purposes of determining the individuals’ tax liability, *viz.*, a partnership form of taxation. This is a convenient way to pass along losses of a new start-up corporation when it is losing money in the early years. Later, the S-corporation election can be rescinded, once the corporation begins earning profits. Caveat: S-Corporations have a limited number of shareholders, who must be individuals, and cannot include non-U.S. citizens or companies.
6. Limited Liability Company (LLC). This is a relatively new phenomenon which combines the benefits of corporate limited liability and “pass through” of profits and losses to the investors. Unlike the S-Corporation, non-U.S. individuals and corporations can be shareholders. An LLC can be taxed federally as any one of the preceding types. Many states, but not all, will follow the federal tax classification.
7. Limited Liability Partnership (LLP). This is a business entity often used by professionals such as physicians and lawyers and affords certain limited legal liability benefits over a sole or partnership practice.
8. Joint Ventures. Companies can enter into agreements, which should be in writing, to work together on certain discrete enterprises, as long as the joint ventures do not violate Federal and State antitrust laws.

One thing people from civil law (as opposed to common law) backgrounds will find very different in the U.S. is the amount of capitalization required for establishing a business in the U.S.:

there is none under most States' statutes. The common standard is: What was a reasonable amount of capital to run the business? In the U.S., entrepreneurs have started their companies on a shoestring, with a few thousand dollars borrowed from friends or family. Hewlett-Packard is a famous example of two engineers starting out tinkering in a garage. The cost of establishing a corporation in Massachusetts is \$375 to file Articles of Organization for a corporation, LLC or LLP, plus relatively modest legal fees to prepare and file the organization papers, the S-Corporation election form, and to obtain a Federal Employment Identification Number ("EIN"), formerly known as a Tax Identification number. Most states charge an annual franchise tax (in Massachusetts it is about \$500/year), and many States – but not all - levy a corporate tax on profits earned within the State.

For new and start-up companies, the U.S. offers a variety of venture capital ("VC") companies and resources. VC companies specialize in early, mezzanine or later private financing and expect to reap the rewards within a discrete 3 to 5 year period when the company is expected to "go public" or be sold. So, when the start-up grows to the point where it cannot expeditiously be financed by family and friends or by bank loans, VC is an option prior to going public.

Companies founded and doing business outside the U.S. most often establish a wholly-owned U.S. subsidiary. Examples are BMW North America and Mercedes-Benz North America. Operating through a U.S. subsidiary can give foreign companies some level of protection against the parent company being sued in the U.S. or being subjected to U.S. taxation. The other important layer of protection is having liability insurance, which is recommended for any business, corporation or other entity, doing business in the U.S.

Litigation in the U.S.

The U.S. and certain of its States more than others, have a well-known reputation for being very litigious. Damages are usually in the nature of compensation for losses, whether from personal injury or contract disputes. Investors can bring stockholder derivative suits and actions under the Federal and State securities laws (see below). And under appropriate circumstances "class actions" are permitted, which may involve thousands of claimants. Some states allow punitive damages which can be several times the amount of the compensable damages, depending upon the jury's discretion and level of indignation at the accused wrongdoer.

Lawyers can represent clients either on an hourly or contingent fee basis. The latter is used extensively in personal injury cases, but can be used in business disputes as well. Generally, each side pays its own attorney's fees and rarely do the courts engage in "fee-shifting", *i.e.*, requiring the losing side to pay the legal fees of the successful litigant. There are some exceptions, such as discrimination and civil rights actions, or by statute in deceit or fraud cases; and in cases where the parties have by their contract provided that the successful party may have its reasonable attorneys' fees paid by the losing party (*e.g.*, promissory notes, mortgages, leases and other types of contracts). In a very few cases judges will assess attorneys' fees if they find that one of the parties asserted frivolous claims or defenses. But this is rare, and losing a case is not of itself grounds for a court ordering fee-shifting.

Civil Law

In the U.S., non-criminal cases are referred to generally as "civil cases", although the U.S. does not generally follow civil codes. The U.S. is primarily a "common law" jurisdiction, with the exception of Louisiana, which historically adopted a civil code from its Spanish and French colonial antecedents. However, over the past 50 years or more, State statutes have established civil codes, such as the Uniform Commercial Code ("U.C.C."), which has been adopted by most States to govern the laws of purchase and sale of goods, replacing the older common law of contracts in that area. The U.C.C. also governs "security interests" to collateralize loans and the laws governing certain banking transactions. The courts, when hearing these civil code cases, often apply the same "common law" interpretations to the civil code, making predictions as to outcome a little less certain.

Mergers and Acquisitions

Generally the various States' business entity statutes set the rules for mergers and acquisitions. The shareholders vote on mergers and those unwilling to accept the acquiring company's shares can generally opt out and seek the fair value of their shares. In order to encourage antitrust enforcement, large combinations must file with the Federal government under its Hart-Scott-Rodino law. This gives the U.S. Justice Department ("DoJ") and Federal Trade Commission ("FTC") an opportunity to review the combination and to object and seek an injunction if the parties do not desist from their efforts to acquire or merge. The review by DoJ and the FTC focuses on whether the combination of large entities,

especially in the same industry, will stifle competition and work to the disadvantage of consumers. The review may also permit the merger contingent upon certain conditions being met – *e.g.*, the sale of certain assets.

Securities Laws

There are both Federal State securities laws. The Federal law is administered by the Securities and Exchange Commission (“SEC”) in Washington D.C. State securities laws, often called “blue sky laws”, date from the time when sharp salesmen could sell “a piece of blue sky” to a gullible investor. The various national and regional stock exchanges, like the New York Stock Exchange and the National Association of Securities Dealers (“NYSE” and “NASDAQ”) are self-regulating organizations for larger publicly traded corporations. Smaller companies can sell shares through private or public offerings of stock, and several smaller exchanges have arisen to serve this niche. All offerings generally need to meet the criteria of both the SEC and State securities regulators which may vary depending on the size of offering, number of offerees, etc. However, these always require truthfulness of the statements made in the company’s Registration Statement and Prospectus or in its private placement memorandum. For a corporation to “go public”, it must file a Registration Statement and Prospectus with the SEC and get approval before it can issue publicly traded shares to investors. The recent Sarbanes-Oxley Act sets stiffer standards and penalties for public companies and its officers and attorneys who make fraudulent statements or omit material information when making public statements as to the companies’ condition and finances.

Employment Law

Each State has its own employment laws, wage statutes and minimum wage laws, as well as its own unemployment security and workers compensation laws. The Federal Government sets a national minimum wage and establishes Fair Labor Standards, as well as administering the Occupational Health and Safety Act (“OSHA”) to protect employees. These laws apply to all private companies and entities. There are also anti-discrimination laws and civil rights laws protecting citizens generally, and particularly applicable to employment, housing and public accommodations.

The U.S. is an “at will” employment nation. In Massachusetts, for instance, a private employer

can fire an employee without providing notice or severance, for any reason or for no reason at all. Even if the employer is wrong about the reason for the firing, it cannot be sued for wrongful termination. The only exceptions from the “at will” rule are terminations for reasons of discrimination and whistleblowing. Having said that, the fact is that most large and reputable companies will provide either reasonable notice (two weeks, generally) and/or severance payments (it varies, but could be as little as 2 weeks or up to one or two weeks per year of service). Notice and severance are at the company’s sole discretion.

Federal and State wage laws can also be surprising. The Internal Revenue Service (“IRS”) has a 14-point test of whether a person is an “independent contractor” (such as an outside consultant or subcontractor) or a direct employee. The government’s interest is in making sure the business entity is deducting and withholding employment taxes (and paying the employer’s share of same), rather than relying on the employee to pay his/her taxes at the end of the year. Similarly, State Wage Laws make an effort to put as many people in the “employee” category, to assure that the State obtains regular withholding taxes and the employees are covered for unemployment benefits and workers compensation insurance. There have been some surprising decisions in the courts of various jurisdictions where so-called independent contractors or consultants have later been labelled employees either by the government or by the courts in suits brought by disgruntled ex-contractors. So, a company must be very careful about labelling the persons working for it.

Conclusion

Doing business in the U.S. is not simple, especially with the layering of Federal and State statutes and common law decision-making by the courts. However, for any small, medium or large company anywhere in the world, the U.S. is an irresistible market in which to operate and sell. One cannot really grow to be a large multi-national business without developing a market in the U.S. at some point in the company's life. With good legal and accounting assistance, many foreign companies have thrived here, and will continue to enter the U.S. marketplace.

Caveat

This report is not intended as legal advice to any particular client or circumstances.

If you have questions about specific areas of concern about doing business in the United States, feel free to contact me.

Marc Redlich, Esq.
Law Offices of Marc Redlich
One State Street, 15th Floor
Boston, Massachusetts 02109
Tel: (617) 720-0900
FAX: (617) 720-0987