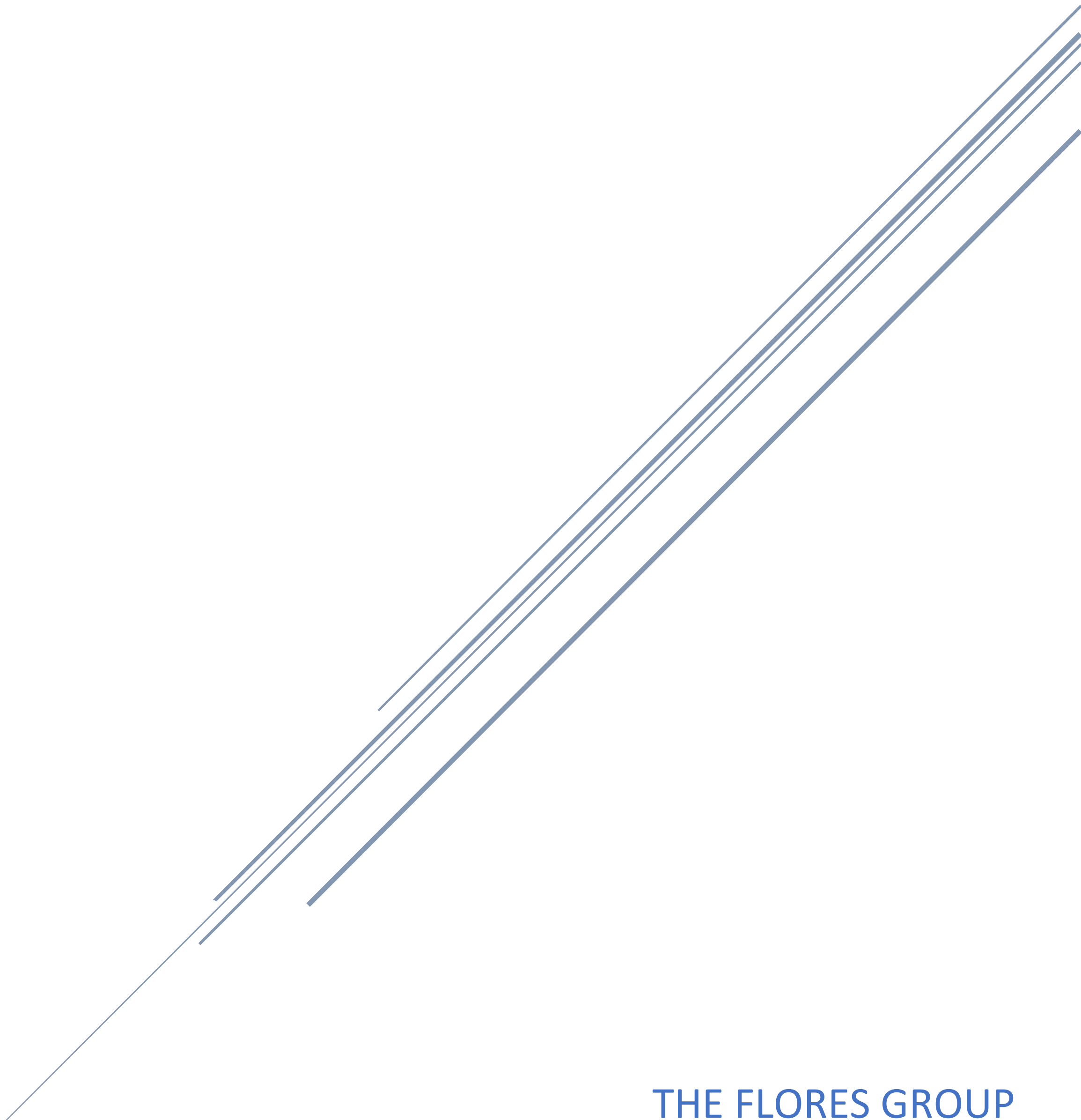
UNITED STATES TAX GUIDES FOR INVESTORS & BUSINESSPERSONS



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1. GENERAL ECONOMIC PROFILE OF THE COUNTRY

Industries

The United States of America is one of the most dynamic economies in the world. The world's super-power is considered a service economy, and although its manufacturing industry is still present, it has been declining over the past decades. It has a GDP of $25.035 trillion (2022 estimate), a GDP-per capita of $70,249 (2021 est.), and a labor force of 162.05 million people (2021 est.) The biggest state economy is California with a $3.09 trillion GDP, followed by Texas with $1.776 trillion, then New York with $1.751 trillion, and Florida with $1.106 trillion. The US has a landmass of 9.8 million km and is home to a great variety of industries. According to the US Bureau of Labor Statistics, the industries that are currently driving the US economy are Healthcare, Technology, Construction, and Retail. Other prominent sectors of the economy include finance, insurance, real estate, rental and leasing, government, manufacturing, and professional and business services.

Commerce

The United States is a major commercial and trading economy. It currently has free trade agreements with 20 countries, one of them being the recently renegotiated United States-Mexico- Canada Agreement ("USMCA", previously known as NAFTA). It also counts with multiple trade & investment framework agreements and numerous bilateral investment treaties. The United States has trade relations with more than 200 countries, territories, and regional associations worldwide. As of 2021 estimates, it is the world's largest importer of goods with a total value of $3.3 trillion.

Government

The United States is a constitutional-based federal democratic republic divided into three branches. Generally, the Legislative branch (divided into the House & Senate composed of elected representatives of each state) enact legislation, the Executive branch (comprised of the president, vice president, and his appointed cabinet & federal agencies) administers the laws enacted, and the Judicial branch (Supreme Court, district courts, etc.) evaluates the laws. The country is divided geographically into 50 states and one

federal district. The state governments mirror the structure of the three branches of the federal government. It is worth noting that all government levels (federal, state, municipalities) have the authority to tax and regulate, thus resulting in different tax rates & regulations across the states. There is a complex system that determines who has the primary jurisdiction over an issue.

Politics

The United States' modern political system is dominated by a two-party system consisting of the Democratic Party and the Republican Party. Although there are other political parties like the Libertarian Party, their influence is insignificant in comparison to the two main parties in the country. Both of these parties dominate the federal, state, and municipal levels of the country. The Democratic Party positions center-left supporting an American Liberalism platform. This platform usually entails a combination of civil liberty and equality ideas in support of social justice with a tighter approach to economics, which often means higher regulation and higher taxes. While the Republican Party positions center-right, supporting an American Conservative platform. This platform usually entails ideas people describe as rugged individualism within Christian/conservative social norms and a laissez-faire approach to economics, which means less regulation and lower taxes.

2. DESCRIPTION AND SOURCE OF THE TAX LAWS

a. *Overview*

The origins of the United States tax laws begin with the Sixteenth Amendment of the United States Constitution. Historically, the U.S. government had relied on tariffs as a source of revenue since the country saw income taxes as controversial at that time. Congress had two significant constitutional issues to overcome before authorizing a federal income taxes: first, what is the source of taxation and second, should the revenues be apportioned among the states based on population. However, on February 3, 1913, the Sixteenth Amendment was Ratified; "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.". Shortly after being

ratified, Congress passed the Revenue Act of 1913, which ultimately eliminated both of these problems and allowed federal income taxes.

b. *Legislative/Statutory Source of Taxes*

After the Revenue Act of 1913, the United States tax laws began to be codified and compiled into the first Internal Revenue Code of 1939. This was later overhauled in 1954 and 1986. The Internal Revenue Code (IRC) of 1986 is the current statutory tax rules enacted by Congress. This is a dynamic document that Congress adds to, deletes from, or modifies provisions at least once a year. In order to enact tax legislation, Congress must act in a systematic process. First, a new tax bill would be drafted by the House Ways and Means Committee, which would then be considered by the whole House. If approved, it moves to the Senate Finance Committee, where the Committee can do revisions, additions, and/or deletions before presenting to the whole Senate. Suppose the bill happens to be substantially different from that original one from the House. In that case, both versions are sent to the Conference Committee (composed of both House and Senate members), where a compromise bill gets drafted. If both the House and Senate approve the Conference Committee's bill, they send it to the President. The President can either veto it or sign it, redesigning it as a tax act and becoming law. The Internal Revenue Code consists of sections (Section 1 – Section 9834). These sections are divided into subsections, paragraphs, subparagraphs, and clauses. The Internal Revenue Code constitutes Title 26 of the U.S. Code (U.S.C.) which is administered by the Internal Revenue Service (IRS – the US tax authority) through its Regulations Rulings.

c. *Administrative Source of Taxes*

Treasury Regulations are the most common source of administrative tax authority. These are the Treasury Departments and the IRS's statements of law which further develop the meaning of the Internal Revenue Code. The Internal Revenue Service (IRS) is the US tax authority responsible for enforcing tax law and collecting taxes. A *Revenue Ruling* explains how the IRS applies the law in certain situations while a *Revenue Procedure* advises taxpayers on how to comply with the IRS on procedural and administrative matters. These provide instruction guidance to taxpayers. They are not

laws in and of themselves, but rather interpretations that help illustrate the IRC rules. Although they are not binding on the Courts, they inform the taxpayers how the IRS addresses certain situations. Nonetheless, it is common for the courts to often follow the IRS position on these documents. It is not common for taxpayers to convince the federal courts that a regulation was an incorrect interpretation of IRC rules.

d. *Judicial Source of Taxes*

The judicial source of United States laws is based on the common law system that evolved from British tradition. This is true for 49 states with the lone exception of Louisiana, which is the only civil law jurisdiction in the United States. In simple terms, common law is derived from judicial decisions instead of from statutes. That is, laws are interpreted by judges and quasi-judicial tribunals and their written opinions on cases. These cases help establish legal precedents, which carry weight for future decisions on similar situations. The same goes for tax law. When questions and issues arise regarding the interpretation or application of tax law, the tax courts (judicial system) steps in. Court decisions are official interpretations and applications of the IRC. Additional tax law is generated and carries the same weight as a statute itself. More is discussed of how a taxpayer can challenge the IRS and go to court on section 5 **(RESOLUTION OF TAX CONTROVERSIES)** of this guide.

3. DESCRIPTION AND TYPES OF TAXES

a. *Corporate Income Taxes (CIT)*

On December 22, 2017, former President Donald Trump signed one of the most significant tax overhauls the US has seen in 30 years. The Tax Cuts and Jobs Act (TCJA) brought substantial benefits to taxpayers in the US. In general, it reduced the federal CIT down to a 21% flat tax rate on taxable income as defined by the Internal Revenue Code from a previous progressive rate that was a maximum of 35% for corporations whose tax year began after December 31, 2017 (the concept of taxable income is very complicated beyond the scope of this guide).

b. State Income Taxation.

In addition to the Federal CIT, forty-four states also impose their own CIT, and rates range from 2.5% in North Carolina to 9.8% in Iowa. The six states that levy top marginal CIT rates of 9% or higher are Alaska, Illinois, Iowa, Minnesota, New Jersey, and Pennsylvania. The ten states with top rates of 5% or below are – Arizona, Colorado, Florida, Kentucky, Missouri, North Carolina, South Carolina, Utah. Others like Nevada, Ohio, Texas, and Washington impose gross receipt taxes, which tend to be seen as less harmful than CITs. South Dakota and Wyoming are the only two states that do not impose CITs or Gross receipt taxes. It is worth noting that State CIT are fully deductible for federal CIT purposes. There has been a common misconception amongst investors in the United States (domestic & foreign) that there are multiple benefits behind opening a corporation in some states is more convenient than other in term of where tax laws & privacy regulations. However, opening a corporation in a different state from where your principal place of business will be conducted has proven to be counterproductive most of the time. We will discuss this later on, but it is essential to consult with your tax advisor before making such decisions.

c. *Tax Due Dates.*

Due dates are complicated and important part of tax compliance. The due date for most tax reporting and filing obligations is March or April 15 of every year. Estimated tax payment due dates are split into four equal estimated payments throughout the year. They are the 15th of the fourth, sixth, ninth, and twelfth months of the tax year. A fiscal year-end (tax year) is usually the end of any quarter, like March 31, June 30, September 30, or December 30. Most companies tend to use a calendar year end, making the estimated payments on April 15, June 15, September 15, and December 15.

d. *Personal Income Taxes (PIT)*

Individuals are subject to a progressive personal income tax (PIT) based on their personal taxable income. The applicable tax rates are determined based on the marital and family status of the individual. This is best illustrated in the following table. Numbers inside the table represent Taxable Income (USD). These are the 2022 PIT rates:

Tax Rate	Single Taxpayers (ST)	Married Filing Jointly (MFJ)	Married Filing Separately (MFS)	Head-of-Household (HoH)
10 %	0 – 10,275	0 – 20,550	0 – 10,275	0 - 14,650
12 %	10,275 - 41,775	20,550 - 83,550	10,275 - 41,775	14,650 - 55,900
22 %	41,775 - 89,075	83,550 - 178,150	41,775 - 89,075	55,900 - 89,050
24 %	89,075 - 170,050	178,150 - 340,100	89,075 - 170,050	89,050 - 170,050
32 %	170,050 - 215,950	340,100 - 431,900	170,050 - 215,950	170,050 - 215,950
35 %	215,950 - 539,900	431,901 - 647,850	215,951 – 323,925	215,951 - 539,900
37 %	539,901+	647,851 +	323,926+	539,901+

Depending on where taxpayers reside, there will also be state and local income taxes. Seven states have no state income tax (Alaska, Florida, Nevada, Texas, South Dakota, Tennessee, Washington, and Wyoming). Forty-one states tax wage and salary income, two states (New Hampshire & Tennesee) only tax dividend and interest income. Nine states have a single-rate tax structure, and the rest have gradual-rate income taxes with the brackets varying widely between. Hawaii has 12 brackets, the most in the country. Tax rates go all the way from 2.9% in North Dakota to 13.3% in California, but the average is around 5%.

e. Alternative Minimum Tax.

The Alternative Minimum Tax (AMT) ensures that high economic income individuals pay at least a minimum amount of tax. The United States AMT is based on *the generation of economic income*, rather than taxable income itself. AMT eligibility and computation is extremely complicated and beyond the scope of this guide. We recommend you consult a tax advisor for this matter.

f. Capital Gains Taxes (CGT)

A capital gain is the growth in value of an investment. For example, let's say you buy a house for $100,000, and you hold the property. After one year you decide to sell the house, which is now worth $150,000 due to appreciation. That $50,000 difference is a

capital gain and is taxable by the government. There are two different types of Capital Gains. Long-term Capital Gains (LTCG), which are incurred when you hold an asset longer than 12 months. And Short-term Capital Gains (STCG) which are incurred when you hold the asset for less than 12 months. Capital Gains and losses are carried to Schedule D from the Form 1040.

Individual Capital Gains: Short-term capital gains for individuals are taxed as ordinary income rates of up to 37%. Long-term capital gains are taxed at preferential tax rates of 0%, 15%, or 20%. Long-term capital gains on "collectibles" (baseball cards, sneakers, wine, etc.) are taxed at a maximum rate of 28%. The preferential tax rates table goes as follow (as of 2022):

Tax Rate	Single Taxpayers (ST)	Married Filing Jointly (MFJ)	Married Filing Separately (MFS)	Head-of-Household (HoH)
0 %	0 – $ 41,675	0 – $83,350	0 – $ 41,675	0 - $55,800
15 %	$41,675 - 459,750	$83,350 - $517,200	$ 41,675 - $258,600	$55,800 - $488,500
20 %	Over $459,751	Over $517,201	Over $258,601	Over $488,501

Corporate Capital Gains: Corporate Capital Gains are not taxed at preferential tax rates. Capital gains are taxed as ordinary income at a maximum rate of 21%.
Capital losses can be netted against Capital Gains along with up to $3,000 ($1,500 if married and filling separate) of other taxable income. The remaining capital losses can be carried over indefinitely to be combined with future capital gains or losses.

g. *Inheritance and Gift Taxes*

Inheritance and gift taxes are adjusted each year due to inflation, so the numbers that we will be reviewing are likely to increase (not considering a potential tax reform). In the United States, there is no inheritance tax; however, there is an Estate & Generation-Skipping Transfer Tax (GST). For 2023, the first $12.92 million is exempt which is doubled for married couples ($60,000 for nonresident aliens) from GST and gift tax and

anything more than the exemption is taxed at 40%. Estate taxes in the United States are considered to be transfer taxes since the donor pays the tax, generally on their final 1040.

Key points on estate taxes: The estate tax applies to all financial and real assets. Estates can deduct debts, funeral expenses, legal and administrative fees, charitable bequests, and estate taxes paid to states. Inheritances are not taxable income to the recipients. Unrealized capital gains on assets are not subject to income tax. The exemption level is portable between spouses, so the exemption of a married couple will be double that of a single. There are also other special provisions to reduce taxes or spread payments over time for family-owned farms and closely-held businesses. We recommend you seek tax advice help from your experts to help with estate planning.

Key points on gift taxes: In 1932, Congress enacted a gift tax to prevent donors from avoiding estate taxes by transferring their wealth before they died. As a consequence, gifts fall under the same exemption of $12.92 million in 2023. That is, gifts reduce the exemption amount available for estate tax purposes. However, there is an annual exclusion of $16,000 in 2022, which is indexed for inflation on increments of $1,000. If a married couple with two children could give their children a total of $64,000 ($16,000 from each parent to each child) each year without owing taxes or counting towards the lifetime exemption, that have the overall effect of reducing their taxable estate for the estate tax purposes and gives their children non-taxable income.

The overall net of estate taxes differ for nonresident aliens. United States residents and citizens are subject to estate taxes on their global estate. That means if a US resident has property in Canada and he/she wishes to transfer it to his/her kids, that estate is subject to US tax. On the other hand, nonresident aliens' estate is only subject to US taxes if such estate is in the United States (i.e. real or personal property that is physically located in the United States) but as a drawback have a low excluded amount of property of $60,000. Any United States situs property amount over $60,000 is considered to be taxable for estate tax purposes. The difference between US residents to nonresident aliens is explained more in detail in section 8 of this guide.

h. *Withholding Tax (WHT)*

Withholding Taxes (WHT) are a concept that international investors and business persons should be aware of. Under the Internal Revenue Code, a foreign person is subject to a 30% tax on *US-source non-business income (FDAP)* which is essentially a flat tax on passive income. Therefore, if a person or company makes *US-source non-business payments* (like *Dividends*, *Interests*, and *Royalties*) to a foreign person, they are subject to report and *withhold* 30% of the gross US-source payments. Foreign persons, or Withholding Agents, can reduce the 30% rate if the beneficial owner certifies their eligibility based on the operation of the US Tax Code or a Tax Treaty. Since the US has entered multiple bilateral income tax treaties in efforts to avoid double taxation and tax evasion, each withholding agent's country tax treatments will be different.

4. DESCRIPTION AND TAX AUTHORITIES

a. *National Agency – Internal Revenue Service (IRS)*

The Internal Revenue Service is the nation's tax collection agency. The IRS also administers the Internal Revenue Code that Congress enacts. As we have previously mentioned, Congress is the legislative body that adds, deletes, or modifies provisions each year to the Internal Revenue Code, the statutory tax rules "book." The IRS releases Revenue Regulations & Revenue Procedures to guide taxpayers about how the IRS might *interpret* certain facts and *how to comply* with them on procedural and administrative matters. Let's remember that the IRS's statements of law do not carry the weight of law, so they are not binding to courts. Nonetheless, federal courts tend to side with the IRS on tax matters.

The IRS falls under the Department of the Treasury. There are only two positions appointed in the organization, the Commissioner of the Internal Revenue Code and the Chief Counsel. The president makes such appointments, and the Senate confirms. The Commissioner is the head of the IRS and serves a renewable 5-year term. The Chief Counsel advises the IRS on legal matters like interpreting and enforcing tax laws. An IRS Oversight Board exists to ensure that the agency treats taxpayers fairly and reviews IRS plans. However, as of January 2021, the IRS Oversight Board does not have enough

members confirmed by the Senate to make a quorum. Therefore, operations are suspended until a quorum is reached.

The IRS is commonly known for being the agency in charge of Criminal Investigations of the Internal Revenue Code and related financial crimes. Their program emphasis in the following areas: Abusive Return Preparer Enforcement, Abusive Tax Schemes, Bankruptcy Fraud, Corporate Fraud, Employment Tax Enforcement, Financial Institution Fraud, Gaming, General Fraud Investigations, Healthcare Fraud, Identity Theft Schemes, International Investigations, Money Laundering & Bank Secrecy Act (BSA), Narcotics-Related Investigations, Non-filer Enforcement, Public Corruption Crimes, and the Questionable Refund Program (QRP).

5. RESOLUTION OF TAX CONTROVERSIES

a. Audits

Audits are probably the most common tax controversy the IRS is known for. As part of their enforcement mission, the IRS audits a selected portion of income tax returns each year. Reasons for an audit vary, but there are some factors that can increase your chances. Common red flags for an audit include: failing to declare the right amount of income, claiming rental real estate losses, making disproportionately large charitable donations compared to income, and claiming higher-than-normal amounts of deductions (particularly business-related ones). Surprisingly, high income is also another attention grabber for the IRS. Individuals with income of more than $1 million have a 3.2 % chance of getting audited compared to a 0.6% chance of those making between $200,000 and $1 million.

b. Tax Courts & Disputes

As previously discussed in section 3, when questions and issues about the interpretation or application of tax law, the courts step in. Taxpayers who disagree with the IRS have the right to challenge them and get their cases to court.

There are three trial courts in the United States: the U.S. Tax Court, the U.S. Districts Courts, and the U.S. Court of Federal Claims. If the taxpayer refuses to pay what the IRS claims, they can file a petition with the U.S. Tax Court to hear their case. Alternatively,

they could also decide to pay the IRS deficiency and sue the government for a refund. In this case, it goes to their local U.S. District Court (or U.S. Court of Federal Claims if the case is situated in Washington DC). The losing party (either the taxpayer or the IRS) can challenge the court's decision and take the case to the U.S. Court of Appeals. If the losing party is still not satisfied, they could also appeal for the case to be heard by the U.S. Supreme Court, but it is worth noting that the Supreme Court hears no more than a dozen federal tax cases each term.

6. LEGAL FORMS OF DOING BUSINESS IN THE UNITED STATES

a. *Sole Proprietorships*

Sole Proprietorships are probably the simplest forms of business for individuals looking to start their own small business. A Sole Proprietorship (SP) is an unincorporated business with only one owner. There are three main areas a person must analyze to see if an SP is their best fit.

Business Partners & Investors: Generally, when two or more people come together for a business purpose that will be considered a partnership. The other alternative is an incorporated entity, whether as an "Inc." or as a limited liability company which elects to be treated as a corporation. However, an incorporated business entity will have more costs associated with the process. Such costs are unnecessary for the vast majority of people looking to starting their own business. Additionally, you can always make the transition to an incorporated entity when the time comes.

Liability Exposure: Using a sole proprietorship generally does not shield you from any kind of legal claims against you and therefore other forms of business are recommended.

Taxes: The self-employment tax is probably one of the most significant disadvantages to SPs. We will explore more on the subject in the next section. To make things simple, if you are planning on starting a business whose net income is not higher than $30,000, an SP can be a good fit for you. Tax reporting for an S or C corporation can be cumbersome.

Business Credit: As a foreign investor in the United States, one of the hardest things to establish is business credit. For this reason, an SP is probably not the best option. If you are trying to establish credit in the US with the help of your business, it is probably best for you to look for an incorporated entity. SPs will not help you with this matter.

b. *Partnerships*

A partnership is defined as a formal arrangement between two or more parties to manage and operate a business and share its profits. There can be different types of partnership arrangements, each serving a different purpose.

General Partnership: A general partnerships is where all parties share legal and financial responsibility equally. Profits are shared, with the specifics being laid out in writing in the partnership agreement. Members are also personally responsible for the debts the partnership takes on. The benefits of a general partnership are usually related to administrative and filling costs. A general partnership is frequently less expensive in setting up as a corporation, LLP, or LLC.

Limited Liability Partnership (LLP): LLPs' primary purpose is to limit partners' personal liability. LLPs are a standard structure amongst professionals like lawyers, architects, doctors, and accountants. If one partner was sued for malpractice, the other partners' assets would be protected from such a lawsuit. Other areas where LLPs come in handy is on compensation and ownership. Firms usually make a distinction between equity partners and salaried partners with the help of LLPs. LLPs offer protection and personalization, but investors should be aware of maintenance costs.

Limited Partnership: A limited partnership is a hybrid between a general partnership and an LLP. In a limited partnership, there must be a general partner with full personal liability for the partnership debts. At the same time, at least one other partner needs to be a silent partner. A silent partner is only liable for the amount he or she invests in the partnership. A silent partner also does not participate in the day-to-day operations of the partnership. Think of a silent partner simply as an investor. Silent partners must be aware that their shares are considered securities and thus are subject to regulation by the federal and state governments. Limited Partnerships are not that common, but they have proven to be useful in family estate planning and investment vehicles in commercial real estate.

c. *Limited Liability Company (LLC)*

A Limited Liability Company (LLC) is a business structure in the US where the owners are not personally liable for the company's debts and liabilities. Think of an LLC as a

hybrid between a corporation and a sole proprietorship or a partnership. Requirements on the formation of an LLC may vary among states, but there are some commonalities throughout. Owners and members must first choose a name that has not been registered before for another entity. Then, the Certificate of Formation need to be filed with the Texas Secretary of State which will result in a Certificate of Filing . These articles will contain very important information about the entity, like who the members are and their addresses, the rights of each of them, duties, liabilities, obligations of each member, rights of each member, the name of the registered agent, and the LLC's statement of purpose. LLCs are suitable for a variety of reasons:
Liability Protection: Like LLPs, LLCs offer their members (owners) personal protection on their assets from possible liability exposure like lawsuits generated by their businesses, products, or services. However, it is stressed that proper maintenance is done on at least a yearly basis. If not done, a corporation's corporate veil can be pierced and thus can lose in court the liability protection once thought. An additional advantage of LLCs over LLPs is the ability to convert into an S-Corp down the road, providing the same asset protection and tax benefits.
Rental Real Estate: Rental Real Estate is a common purpose for LLCs. The LLC protects their members from liability as long as they acted within their scopes of duties and without negligence. Additionally, some states like Texas allow for Series LLC. Business owners and investors understand the importance of isolating assets from liability exposure. Historically, business owners have created multiple LLCs for their rental properties to do so. This can be both costly to do and maintain. A Series LLC has the ability to establish "mini-LLCs" within a parent LLC. Helping isolate each "mini-LLC's" assets, liabilities, debts, and obligations. Structured and maintained property, a Series LLC can be more effective than multiple LLCs.

LLCs are the most commonly known business entity of foreign investors in the US. LLCs provide many benefits; however, they are not the answer to all problems. Additionally, there is much misinformation around LLC. Many investors fall into the trap of opening an LLC in states like Delaware, Nevada, and Wyoming because of rumors of additional privacy protection and tax benefits. This is not only wrong but can be costly to investors.

Opening an LLC in states that you are not conducting your principal place of business defeats most tax and privacy benefits previously thought.

d. S Corporations

S Corporations (S-Corps) are probably one of the most overlooked business entities; however, they possess many benefits for business owners. To be an S-Corporation shareholder, you need to be a US Citizen or *at least a resident alien for tax purposes*. Two tests can be done to determine this status, of which one of them must be met. Both of these tests are described more in detail in section 8 **(TAXATION OF FOREIGN INVESTORS IN THE COUNTRY)** of this guide. Every year, foreign investors have to pass one of these tests to be eligible to be a shareholder of an S-Corp.

S Corporations are also known as an S Subchapter, which refers to a type of corporation that meets certain IRS requirements. In addition to being required to be a domestic business owner, an S-Corp needs to have 100 shareholders or less. For this reason, there must only be one class of stock in an S-corp. Additionally, S-Corp shareholders can only be individuals, certain tax-exempt organizations, specific trusts and estates, but not corporations or partnerships. S-Corps are also required to have a board of directors unlike sole proprietorships and LLCs. The number of directors varies across state law. Lastly, in order to be become an S-Corp, the shareholders of the corporation must submit signed Form 2553, *Election by a Small Business Corporation*.

Similar to LLCs, S-Corps give their shareholders asset protection from liability exposure. However, the major benefits of S-Corps are tax strategies, which are discussed in detail in the next section.

e. C-Corporations

A C-Corporation is a legal structure in which owners and shareholders are taxed separately from the corporation. This structure creates a double taxation problem, which will be explained in detail in the next chapter. Nonetheless, a C-Corporation shares a lot in common with an LLC and an S-Corp. Like an LLC, the first step in forming a C-Corp is picking and registering an unregistered business name. Then, the Articles of Incorporation must be filed with the Secretary of State. The C- Corporation, unlike the S-

Corp, can have more than 100 shareholders. The issuance of this stock is upon the creation of the business. C-Corporations also allow for different classes of shareholders which can help determine each class's voting rights (unlike an S-Corp). A board of directors is also required for a C-Corporation; again, the required number of directors may vary across states. C-Corps are also required to have annual meetings with shareholders and the board of directors. They are also required to maintain the minutes of these meetings.

Almost all Fortune 500 companies are C-Corporations. C-corps are structured to facilitate having thousands of shareholders. Thus, after meeting a certain threshold, a C-Corps must register with the Securities and Exchange Commission (SEC). C-Corps are a great entity to raise capital and go public. However, maintenance can be costly. Furthermore, C-corporations also have the ability to re-structure their business through mergers which can be tax free if performed correctly.

7. TAXATION OF EACH BUSINESS FORM

a. *Sole Proprietorships*

As previously noted, a sole proprietorship is an unincorporated business; there is no legal entity created. However, a sole proprietorship falls into the category of "pass-through entities." Pass-through entities (or flow-through) are not subject to corporate income taxes. Instead, profits or losses are passed through to the owners or members to their personal income tax returns.

<u>SECA Taxes:</u> Self-employed people pay Self-Employed Contributions Act (SECA) taxes to fund Social Security and Medicare. On the other hand, employers are required by law to withhold taxes from employee earnings to fund these programs, these are known as Federal Insurance Contributions Act (FICA) taxes. As of 2021, SECA taxes are 15.3% on ordinary net income of up to $142,800 ($137,700). The SECA Tax consists of a 12.4% Social Security tax [or railroad retirement (tier 1) tax], and a 2.9% Medicare tax. If your ordinary net income surpasses the $142,800 ($137,700) threshold, you don't have to pay the 12.4% Social Security tax [or tier 1 tax] on the net earnings in excess of the threshold.

However, you still have to pay the 2.9% Medicare tax. An additional 0.9% Medicare Tax applies to net income at or above $250,000 married filing jointly, $125,000 married filing separate, or $200,000 for single filers and head of households. Self-employed individuals are allowed to deduct the cost of health insurance from net earnings. In order to pay these taxes, an individual has to have a Social Security Number (SSN) or an Individual Taxpayer Identification Number (ITIN). Nonresidents and resident aliens are not eligible for an SSN; thus, they have to apply for an ITIN.

As a Sole Proprietorship owner, you are required to pay SECA taxes. Schedule SE from Form 1040 (or 1040-SR) will be used to file self-employment taxes. Nonetheless, individuals must also list the business' profits or losses information on Schedule C for Sole Proprietorships. Estimated taxes can be overlooked sometimes, but they are important to remember. As a Sole Proprietorship owner, you do not have an employer withholding taxes from your paycheck. Thus, you are responsible for estimating the amount of taxes you will owe at the end of each year, and you should make quarterly payments to the IRS.

Sec.199A Pass-Through Tax Deduction: Aside from lowering corporate taxes to a 21% tax rate, the TCJA gave pass-through entities as much as 20% deduction on qualified business income. This deduction can get complicated and technical, so it is recommended to meet with a tax professional.

b. *Partnerships*

Just like a Sole Proprietorship, Partnerships fall into the category of pass-through entities. They do not have to pay any corporate taxes, but instead, profits and losses pass through to their partners. Regardless, partnerships are required to file an annual report, Form 1065 (U.S. Return of Partnership Income). This return reports the total of the entity's income, deductions, gains, and losses, and then these items are allocated to the partners, each on a separate Schedule K-1. Each partner is given a copy of their own Schedule K-1 showing their allocations. An individual partner's allocation is counted on their personal income tax return.

General Partners are subject to SECA taxes on all of their net income. Limited Partners, on the other hand, are only subject to SECA taxes on their guaranteed payments. Partnerships are also entitled to the QBI deduction discussed in the Sole-Proprietorship section from this chapter.

c. *Limited Liability Company (LLC)*

An LLC also generally falls into the category of being a pass-through entity unless otherwise elected. There is a misconception that opening an LLC will instantly bring tax benefits to the members. This is false; members are also subject to SECA taxes on their ordinary income derived from the business. Passive income, on the other hand, is not subject to SECA taxes. Passive income includes rental income, interests, dividends, capital gains, and royalties. We make this distinction noteworthy because LLCs are the primary business entity investors use for rental real estate.

Single-owner LLCs are treated by the IRS as sole proprietorships for tax purposes. Therefore, profits and losses will be reported on Schedule C of Form 1040.
Multi-Owner LLCs are treated by the IRS as partnerships for tax purposes. Therefore, members will pay their taxes of their respected share of their profits using a Schedule E attached to their income tax returns.

However, LLCs can be a versatile business entity, and with the correct tax strategy, there can be very useful. LLCs can choose to be treated as corporations for tax purposes and benefit from a 21% tax rate on taxable income. This is a lower tax rate than the higher individual tax bracket rates of 22%, 24%, 32%, 35%, and 37%. This can cause problems in certain situations since being treated as a corporation means double taxation.
Other strategies like making the members of the LLC be another S-Corp or a Trust can be implemented for further tax benefits. We recommend consulting with a tax professional since it can get technical, and the best fit may vary depending on the individual's situation.

d. S-Corporations

S-Corporations are the last of the pass-through corporations we will be talking about. S-Corps pass their income and losses to their shareholders. Like for a partnership tax return, there is allocation of income, deductions, gains, losses, and credits via Schedule K-1, to, in this case, each shareholder. Also, like for a partnership, in this case, each shareholder is given a copy of their respective Schedule K-1 and their allocation is counted on their personal income tax return. This avoids the double taxation for corporations, but it allows for Self-Employment taxes. Nonetheless, there are some benefits unique to S-corps from other pass-through entities.

S-Corporations can avoid paying the SE tax on net income. If shareholders would take a *reasonable payroll* (salary) through a W-2, it can reduce a good portion of the profit as net income under the K-1 and thus create further saving on SE tax. It is important to emphasize the word *reasonable*. It is known that IRS challenges and audits shareholders that abuse this strategy. Therefore, it is important to consult with a tax specialist if you wish to pursue this strategy since each situation is specific to the individual.
In addition to the strategy talked above, the S-Corporation can also interplay with the Sec. 199A deduction of as much 20%.

e. C-Corporations

C-Corps are tax entities that are taxed separately from their owners and shareholders. C-Corporations will file financial disclosure reports, financial statements, and annual reports. All C-corporations are required to file a *U.S. Corporation Income Tax Return* Form 1120. All C-corporations are also required to file a Form SS-4 to receive an Employer Identification Number (EIN). A C-Corporation will pay corporate income tax on its income (after expenses, losses, deductions, and credits). A corporation will then pay dividends to its shareholders from this after-tax income. Finally, the shareholders will then pay personal income taxes on these dividends, thus creating the so-called double taxation problem.

8. TAXATION OF FOREIGN INVESTORS IN THE COUNTRY

a. *Foreign Individuals*

Foreign investors & businesspersons must be careful about their tax residency in the United States. A foreign individual is taxed in the United States when he or she is considered a tax resident (or resident alien in IRS terms). In order to be regarded as a resident alien for tax purposes, a foreign individual must meet one of two tests:
The Green Card Test – if an individual holds a Form I-551, he or she qualifies as a resident alien.

Substantial Presence Test – An individual has to be physically present in the US for at least 183 days; OR, present at least 31 days of the year in question, and present for 183 days summing from days of the target year, plus days in the first preceding year counted as one-third days, plus days in the second preceding year counted as one-sixth days.
The Substantial Presence test holds several exemptions to which days can be counted as presence in the United States. Additionally, several types of visas are also exempted from this test. It is recommended to consult a tax professional for this matter.

As a resident alien, you are subject to income taxes in the United States on all of your worldwide income. A foreign individual classified as a nonresident alien can only be taxed on US source business & non-business income (unless a tax treaty can be claimed). There can also be years where individuals qualify for both nonresident and resident alien status; thus, a dual-status income tax return needs to be filed. In some cases, aliens can make elections that override both tests, most commonly seen with tax treaty countries.

b. Foreign Corporations

For taxation purposes, a foreign corporation is similar to a nonresident foreign individual. That is, foreign corporations are taxed on all US source income unless a tax treaty applies. Foreign corporations do not have to pay taxes on their worldwide income. However, some exceptions may apply. Some foreign countries have tax treaties with the United States where their resident corporations are allowed to be taxed at a preferred rate or not taxed at all on their U.S. source income. Nonetheless, such companies should be careful to avoid issues like creating a permanent establishment in the US where it could

override their preferential treatment. Setting a proper structure for a business can be implemented with the help of a tax professional.

9. TAXATION OF INTERNATIONAL OPERATION OF RESIDENTS

a. *Overview*

In order to tax nonresident aliens, the United States uses two different taxing theories which are known as the 'Worldwide Taxation regime' and the 'territorial regime'. In a Worldwide Taxation Regime, residents are taxed on their worldwide income. To eliminate the same income being taxed by two jurisdictions, credit is taken on the resident jurisdiction tax return for taxes paid to other tax jurisdictions. In a Territorial Regime country, residents are not subject to taxes on income earned elsewhere than their resident jurisdiction. Taxpayers will allocate the total income among various jurisdictions and report to the appropriate one; credits are not taken. United States citizens and resident aliens are taxed on their worldwide income. However, up to $112,000 of foreign earned income may be excluded from a United States citizens and residents income that live abroad. US firms can credit foreign income taxes paid or accrued during a taxable year.

b. Foreign Tax Credit

A Foreign Tax Credit (FTC) is a form of relief from double taxation on foreign earned income. An FTC only applies to income taxes; foreign excise taxes, sales taxes, transfer taxes, and property taxes are not creditable. An FTC is subject to a significant limitation. The annual credit cannot exceed a specific percentage of the precredit U.S. tax for the year. This percentage is the taxpayer's foreign source income divided by taxable income. Seeking advice from a tax expert is recommended when it comes to FTCs.

c. GILTI

GILTI, or Global Intangible Low Taxed Income, is the attempt by the United States government to tax value held offshore which they deem to be above a normal rate of return. It was originally introduced in the 2017 Tax Cuts and Jobs Act. Although the GILTI formula is complicated, the amount tax is roughly equal to the gross income of the

foreign corporation minus the ‘deemed tangible income return’. The deemed tangible income return is basically the depreciable assets of the business minus any interest expense attributable to the foreign corporation. If the aggregate earnings in a controlled foreign corporation exceed what Congress thinks is a ‘routine’ profit margin, then that amount is taxed by GILTI here in the United States. The takeaway for the taxpayer is that when they are a United States shareholder and they own over 50 percent of the voting power or value in a foreign corporation, the taxpayer needs to be aware that there are compliance issues due to GILTI.

d. *PFIC*

A Passive Foreign Investment Company (PFIC) is a corporation located abroad that meets one of two conditions:

– At least 75% of their income is passive

– At least 50% of the company's assets are investment

United States investors that own shares of a PFIC must file a Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, with the IRS.

In 1986, Congress wanted to close tax loopholes that allowed US taxpayers to shelter offshore investments from taxation. Congress not only wanted to bring such investments under US taxation, but they also wanted to discourage taxpayers from this practice. Sections 1291 through 1298 of the US Income Tax Code define PFICs. Form 8621 is intricate; it is estimated to take around 40 hours to fill out. Generally, investors turn to tax professionals for assistance and guidance on PFICs & Form 8621.

e. CFC

A Controlled Foreign Corporation (CFC) is a corporate entity that is registered or conducts business in jurisdictions or countries different than the residence of their controlling owners. Under IRC § 957, the term controlled foreign corporation means any foreign corporation if more than 50 percent of the total combined voting power of all classes of stock or the total value of the stock of such corporation is owned or considered as owned by United States shareholders. United States shareholders means a United

States person who owns 10 percent or more of the total combined voting power (or value) of all classes of stock. CFCs prove to be advantageous when the cost for setting up a business, partnerships, or foreign branches is less than the tax implication costs.

10. TAX TREATIES AND GENERAL PROVISIONS

a. U.S. Overview

We have gone over how the US is a Worldwide Regime tax system. Since the US doesn't surrender its jurisdiction of US nationals & firms' income taxes, a problem of potential double taxation arises. Tax treaties help alleviate double taxation problems or even exempt taxes on certain items and individuals from different countries. Tax treaties are also useful for countries that wish to encourage trade and investment, information exchange, and cooperation in enforcing and administering tax laws. Each tax treaty is unique; rates and exemptions vary among countries. Currently, the US has bilateral income tax treaties with more than 60 governments. By filing a W-8BEN, the taxpayer claims the benefits provided to their country nationals under the US tax treaty, reducing the rates of income taxes, withholding taxes, and any other additional benefits provided.

b. *Canada*

The United States has the United States – Canada Income Tax Convention, signed in 1980 and entered into action in August 1984. Additionally, a second protocol that modified the convention signed in 1980 with respect on taxes on income and on capital done was signed in September 2007. Canadian investors need to be aware of this treaty and use it to their advantage.

Canadian residents are allowed to invoke the US-Canada Income Tax Treaty on their US source income. Similarly, US residents (or resident aliens as previously discussed) are allowed to invoke the treaty on their Canadian source income. To claim the benefits of a tax treaty that overrides or modifies any provision of the Internal Revenue Code, an individual must complete a Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b),* and attach it to their tax return.

One of the tax treaty's intentions was to provide tax relief in both the US and Canada and avoid double taxation. Both Canada and the US are considered Worldwide Tax Regime systems, meaning their citizens get taxed on their worldwide income. Without proper preparation and structure, Canadian citizens & residents can pay US taxes on their US income to the IRS and pay again to the Canada Revenue Agency. However, in practice, under the tax treaty, Canada can be made to be a territorial tax regime.

Another benefit the treaty implemented was reducing the amount of withholding taxes. Under US tax laws, a foreign person is subject to a 30% tax on US-source non-business income. This rate can be reduced for Canadian citizens and residents by filling out a Form W-8BEN, which makes the taxpayer promise to declare US income on their Canadian tax return. This process allows for individuals to be subjected to reduced withholding rates, also called beneficial rates.

The treaty also allows for information (bank accounts and investment account balances, etc.) between the CRA and the IRS to be exchanged.

c. *Mexico*

The United States has the United States – Mexico Income Tax Convention, signed in 1992 and entered into action in November 1993. Additionally, a second protocol that modified the convention signed in 1992 to help avoidance of double taxation and prevent fiscal evasion on income taxes was signed in September 2002.

Mexican residents are allowed to invoke the US-Mexico Income Tax Treaty on their United States source income. Similarly, United States residents (or resident aliens as previously discussed) are allowed to invoke the treaty on their Mexico source income. To claim the benefits of a tax treaty that overrides or modifies any provision of the Internal Revenue Code, an individual must complete a Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b),* and attach it to their tax return.

Similar to the US–Canada tax treaty, the US–Mexico Income Tax Convention provides tax relief designed to reduce double taxation in both countries. Mexico is also considered a Worldwide Tax regime system. Mexico requires Mexican residents to file Mexican taxes with the Mexican tax authority Secretaria de Administración Tributaria (SAT). Again, without the proper structure, Mexican nationals can pay US taxes on their US income to the IRS and then pay Mexican taxes to the SAT, creating a double taxation problem.

Similar to the US-Canada treaty, the US-Mexico treaty reduces the amount of withholding taxes. Foreign persons are subject to a 30% tax on US-source non-business income. By signing a Form W-8BEN, Mexican nationals promise to declare US income on their Mexican tax return. This process allows for individuals to be subjected to reduced withholding rates, also called beneficial rates.

The treaty also allows for information (bank accounts and investment account balances, etc.) between the SAT and the IRS to be exchanged.

Disclaimer

In January 2021, there was a change in the presidential administration. It is natural that in these events, tax law changes. Tax rates for residential & foreign taxpayers in the U.S. may change. It is already a known fact that President Joe Biden is expected to change tax rates for individuals & corporations as well as the estate and gift tax regimes. Secondly, as a general rule, tax law shifts in its meaning on a near annual basis regardless of which presidential administration is in office. Therefore, any information provided in this guide is as up to date as possible but it is incumbent upon the reader to confirm the details of the tax law or consult with FGA in order to determine tax effects with their particular facts and circumstances.