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 UNIVERSITY OF
SOUTH CAROLINA
School of Law

***Advising Foreign Businesses About American
State and Local (Subnational) Taxation***
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Presented by David A. Fruchtman

I. Why is this important?
Who is your potential client?





FOREIGN OPERATING COMPANIES



Entities incorporated abroad are often called
“Alien corporations”



2013:
\$2,756,586,000,000
in total imported goods and services

http://www.census.gov/foreign-trade/Press-Release/current_press_release/
(Exhibit 1)

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2013:
\$189,090,000,000
in imported consumer goods (no separate charts for
consumer services)

http://www.census.gov/foreign-trade/Press-Release/current_press_release/
(Exhibit 6)

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Dollar to foreign currency exchange rates:

USD per unit

	Euro	Pounds	Yuan	Yen	Shekel
2001	0.941400000	1.492600000	0.1209570119	0.0087450809	0.2481389578
2005	1.3623978250	1.9194963724	0.1208211002	0.0097484892	0.2314814851
2009	1.3943336868	1.4516463785	0.1465510608	0.0109750192	0.2629020460
2014	1.3673304136	1.6453290161	0.1652677772	0.0095377269	0.2865612064
Change to purchasing power 2001 to 2014	Down 45%	Down 10%	Down 37%	Down 9%	Down 15%

Source: <http://www.xe.com/>.

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Very Simple Economics:



A weak dollar
=
more expensive imports
=
reduced purchases of
foreign goods

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What will happen when the dollar strengthens...?

Foreign compliance with state tax requirements is *weak*

WHY?

1

Lack of understanding

2

Lack of audits

Compliance Issues



Start-ups vs. Mid-sized companies vs. Large companies

II. Substantive Issues

A. General Principles



Federal constitutional requirements

- ✓ Due process, equal protection and perhaps all federal constitutional protections available to domestic corporations
- ✓ Foreign Commerce Clause



Commerce Clause.

Article 1, Section 8, Clause 3 of the U.S. Constitution:

“The Congress shall have the power to...regulate commerce with foreign nations, and among the several states, and with the Indian tribes.”

Commerce Clause requirements for state taxation of domestic companies, as set forth in

Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1977):

- 1 must be applied to an activity with a substantial nexus with the taxing state;
- 2 must be fairly apportioned;
- 3 must not discriminate against interstate commerce; and
- 4 must be fairly related to services provided by the taxing state

Foreign Commerce Clause adds two requirements for state taxation of foreign commerce:

- 5 must not create unconstitutional international multiple taxation;
- 6 must not impair federal uniformity in an area where federal uniformity is essential by preventing the United States from speaking with one voice in regulating foreign trade.

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)

What is foreign commerce? More than mere foreign incorporation?

See dissent in
Kraft General Foods Inc. v. Iowa Dept. of Revenue and Finance, 505 U.S. 71 (1992).



TAX PRESENCE

is the major stumbling block for foreign businesses.

TAX TREATIES

and the concept of a “permanent establishment”

P.E. is a
“fixed place of business.”





CAUTION!
Tax treaties generally do not apply to states.

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CAUTION!
P.E. is not a state tax concept

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Tax presence for state tax purposes
"SUBSTANTIAL NEXUS"

COMPARE:	P.E. ?*	Substantial Nexus?
Maintaining a stock of goods belonging to the foreign business solely for the purpose of storage, display or delivery.	NO	YES
Maintaining a fixed place of business solely for the purpose of purchasing goods or collecting information for the foreign business.	NO	YES
Maintaining a stock of goods belonging to the foreign business solely for the purpose of processing by another enterprise.	NO	YES

*Per U.S. Model Income Tax Convention of November 15, 2006 (Art.5)



CAUTION!

Delaware corporations are not exempt from state tax.

Misconception is based on a misunderstanding of Delaware Code §§1902(b)(6) and (8), which provide exemptions from Delaware income tax.

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De minimis presence is not a tax planning concept

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B. Sales And Use Taxes

The most significant exposure for many foreign businesses

SALES AND USE TAX RISK

- ✓ Unknown tax presence and failure to collect
- ✓ Known tax presence and failure to collect proper amounts
- ✓ Known tax presence, tax collection but failure to remit



When advising foreign businesses always
discuss responsible person exposure

C. Income Taxes

INCOME TAX ISSUES (I)

- ✓ Confusion over tax presence
- ✓ Federal conformity. How far does it go?
 - ▶ "Taxable Income"
 - ▶ What if conformity leads to discrimination against foreign commerce? *Kraft*

INCOME TAX ISSUES (II)

- ✓ Unitary Groups. Worldwide filing vs. Water's Edge filing
- ✓ Water's Edge issues
 - ▶ Tax haven
 - ▶ Parent of group
- ✓ Consequences of market-based apportionment

LOOSE ENDS



Some states -- for specific taxes -- protect activities beyond the tax presence requirements of the U.S. Constitution (E.g., Illinois use tax temporary storage exemption (35 ILCS 105/3-55(e))



Escheat of unclaimed property. Every state has these laws. However, even among tax compliant companies, there is little knowledge or compliance with escheat laws
For a primer, see <http://www.statetaxalert.us/articles/NYU02.pdf>

When a Foreign Corporation Discovers a State Tax Liability



The Crystal Ball.
Where Are We Headed Over the Next Five to Ten Years?



- ✓ Federal Sales tax legislation
- ✓ More audits
- ✓ Responsible person liability
- ✓ And, ultimately, greater compliance

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Questions????



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- ✔ Has advised clients regarding taxes in all 50 states.
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