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GACC Midwest Presents: Easy & Effective EXPERT WHITE PAPERS



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SETTING UP YOUR U.S. COMPANY

The United States (“U.S.”) market is the largest buyer’s market in the world. Therefore, for most German businesses, it is a natural market to expand into. In addition, the low cost of energy and skilled work force in Colorado and the U.S. make the U.S. a very attractive location for German manufacturers. This article covers the following topics for German companies wishing to do business in the U.S.:

- Choosing the type of entity for your U.S. operations
- Information required to form your U.S. company
- Basic employment issues

FORMING A CORPORATION

Type of corporate entity –Corporation or LLC

Generally, a German company’s U.S. subsidiary will take the form of either a corporation (“Inc.” or “Corp.”) or a limited liability company (“LLC”). There are key differences between the two. A corporation is a company where ownership is represented by shares in the corporation much like an Aktiengesellschaft. A corporation does not have “flow-through” taxation but provides its shareholders with limited liability. In other words, the corporation files its own tax return and pays corporate income taxes on its profits. If it pays dividends to its shareholders, the shareholders are taxed on those dividends paid to them. There is therefore potential for double taxation. Liability for the individual shareholders is limited to their investment in the corporation. In contrast, a LLC has both “flow-through” taxation and limited liability. The owners of an LLC are known as “members” not shareholders. They hold membership interests in the LLC not shares of corporate stock. LLCs do not pay federal or state income taxes. All profits and losses of the LLC are passed through to the members who then declare the profits or losses on their personal tax returns. (The LLC may be required to file an informational return with the IRS). As with shareholders, the members of the LLC are generally not liable for the actions of the LLC.

While different tax and legal considerations dictate whether a German company should use a corporation or an LLC, generally German parent companies operating in the U.S. use corporations. Using a LLC means that the German parent company, as owner of the LLC, must directly file a U.S. tax return and pay U.S. taxes with respect to the income and loss of the LLC. This means that the German parent company will be required to list foreign source income that is treated as effectively connected to a U.S. trade or business by the Internal Revenue Service (“IRS”). This and other elements of filing a U.S. tax return may complicate

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the German company's tax filings whereas, in the case of a corporation, the newly created corporation, not the German parent company, would file the U.S. tax return and pay its taxes. Second, by filing a U.S. tax return, the German company is more exposed to the risk of audit by the IRS which has authority to conduct worldwide investigations. Consult with a U.S. or German tax advisor for more information.

What is a Delaware Corporation?

All corporations must be formed in one of the U.S.'s 50 states. The state in which the entity is incorporated or formed does not need to be the state where the offices or headquarters will be located. Each of the 50 states has its own statutes (Corporation Code) that govern the laws for corporations. Most state's Corporation Codes are based on the corporation code of the State of Delaware, which was the first state to enact a comprehensive corporation code. Hence, the corporation codes of each state are substantially similar to the other states. There is no federal law governing corporations.

Delaware is typically the desired state of incorporation for companies that expect to have their shares registered with the Security and Exchange Commission and listed for sale to the public on a stock exchange. More than 50% of Fortune 500 companies are incorporated in Delaware. Delaware offers the following advantages:

- Delaware's general corporation law provides flexibility for management in running a business.
- Delaware state income tax generally is not levied on corporations not doing business in Delaware.
- The Delaware Court of Chancery is arguably the most respected business court in the United States.
- Delaware has a long established and respected body of corporate law.

However, formation of a corporation in Delaware is generally more expensive than formation of a corporation in a state such as Colorado. In addition, annual maintenance of the corporation, including maintaining a registered agent in Delaware and fees required by the state each year are generally higher than other states. We therefore advise German clients to form their wholly-owned U.S. subsidiary companies in the state where they plan to locate their primary place of business in the U.S.

Setting up the Corporation

There is no requirement for a minimum capital investment (Stammkapital) in the new corporation at its formation and a corporation may have only one shareholder.

To form the corporation we will need to know:

- (a) The name of the U.S. corporation that you want to use;
- (b) Address of your local operation;
- (c) Name and address of a registered agent (we can provide this service);
- (d) Names and addresses of the initial shareholders
- (e) Names and addresses of the initial board of directors
- (f) Names and addresses of the initial officers
- (g) Number of shares to be issued to the initial shareholder.

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(h) Amount of capital that the initial shareholder is investing (this is normally the amount of money required to set up the corporation, including funds to obtain telephone and internet service, hire a manager, pay the legal fees and filing fees required to form the corporation, lease office, warehouse, or industrial space and similar expenses. Capital can be contributed later as well.

(i) Identity and social security number of the corporation's initial officer. It is most convenient when the corporation hires a U.S. citizen who has a social security number to serve as president or Chief Operating Officer or other senior management position. That allows us to use that person's social security number to apply for the corporation's Employer Identification Number (EIN) from the Internal Revenue Service. The EIN is required before the corporation will be allowed to open a bank account.

CORPORATE GOVERNANCE

Corporations use the following basic governing structure:

Shareholders

The corporation is owned by its shareholders. Each shareholder has one vote for each share of the corporation's stock he, she, or it owns. Therefore, if a shareholder owns 51% of the shares, that shareholder can elect all of the directors and will control the corporation.

Board Of Directors

The corporation's bylaws establish the number of directors that the corporation must have. There is a statutory requirement that if the corporation has one shareholder, it must have a board of directors consisting of at least one director. If there are two shareholders, then two directors are required and if there are three shareholders, three directors are required. If there are more than three shareholders, then the minimum number of directors is three, but the Shareholders may choose to have more than three directors.

The Board of Directors is responsible for appointing corporate officers and establishing the general direction of the business. All significant decisions such as hiring or firing key management personnel, making large capital expenditures, borrowing money, or entering into a real estate lease or purchase agreement are normally approved by the Board of Directors.

Officers

The day-to-day operations of the corporation are the responsibility of the corporation's President, Vice President, Secretary, and Treasurer. Many corporations also have a Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operating Officer (COO) and Chief Technology Officer (CTO). These positions are optional and must be created in the corporation's bylaws. One person can serve as both the President and the Secretary/Treasurer. The Board of Directors has the ability to determine what officer positions that the corporation will have.

Only the officers have authority to enter into contracts that will bind the corporation. Therefore, it is important that the corporation have someone who serves as the president from the date the corporation is registered with the Secretary of State.

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EMPLOYMENT ISSUES

Employment Contracts: Most non-management employees in the U.S. do not have written employment contracts. Instead, a letter containing the hourly wage to be paid and a brief description of benefits, vacation, sick leave, etc. is common. In many cases, companies require their employees to sign confidentiality agreements to protect the corporation's trade secrets and other confidential business information.

Wage or Salary: In the U.S., full-time employees typically work 40 hours per week. Employees may work more than 8 hours per day but not more than 40 per week unless they are paid overtime. For those employees who do work more than 40 hours in one week, standard overtime is the employee's hourly wage multiplied by 1.5 and work on holidays is compensated at the hourly wage multiplied by 2.0.

Vacation: Paid vacation is not required by law, but if paid vacation is offered, two weeks (10 days) per year is common. Some companies offer three weeks (15 days) per year for long-serving employees. Three weeks or more paid vacation is less common.

Holidays: There are six official holidays each year, including New Years Day, Memorial Day (Last Monday in May), Independence Day (4th of July), Labor Day (First Monday in September), Thanksgiving Day, and Christmas Day. Other optional days are Martin Luther King Day, Presidents Day, the day after Thanksgiving, and Christmas Eve.

Sick Leave: Like vacation time, paid time off when an employee is ill is not required, as a general rule, by state law. For those companies that offer time off for illness, it is common to grant employees five paid days off for illness per year. There is a trend to combine sick days and vacation days into one category called Personal Time Off (PTO) to make accounting for the time off easier.

Health Insurance: Small businesses (companies with fewer than 50 full-time employees) are not required by law to provide employees with health insurance, but many small companies nevertheless offer health insurance in order to attract the best workers. If a corporation does choose to offer health insurance, all corporate employees must be offered the same insurance benefits. Insurance is normally offered to cover the employee only, but often the employee is given the option to purchase family coverage. Also, the employee normally pays a percentage of the health insurance cost (up to 50% is common), but again this is not required by law. It is up to the employer. In addition to health insurance, dental, vision, life and disability insurance are commonly offered.

Wages: Wages are generally paid monthly, twice each month, or weekly, and no "13th Month" wage is paid. The employer is responsible for withholding taxes from wages. Payment via bank transfer (direct deposit) is becoming more common but payment by check remains the most common practice for small businesses.

Eligibility: Each corporation must verify all employees' eligibility to work in the U.S. and file an I-9 form for each.

Salary versus Hourly: All employees who earn less than \$47,476 per year (effective as of December 1, 2016) must be paid on an hourly basis and are entitled to be paid overtime if they work more than 40 hours in a week. Many employers do not want to keep track of an employee's hours and think it is more efficient to pay the employee a flat weekly salary. The problem that arises is that often the employee works more than

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40 hours per week and then claims overtime pay at a later date. Since the corporation has no records of the employee's actual hours, the corporation normally cannot prove that the employee did not work the overtime claimed. The Department of Labor will then require that the corporation pay the employee the overtime plus interest and pay the government a penalty.

Independent Contractors: U.S. laws defining who can be considered an independent contractor are similar to those in Germany. Many employers hope to avoid withholding taxes from a worker's wages and avoid paying the employer's share of state and federal taxes, Social Security, Medicare, Worker's Compensation Insurance, and Unemployment Compensation contributions for those workers. There are tests used by the State and Federal taxing authorities to determine whether a worker is actually an independent contractor or an employee. Many employers have paid employees as independent contractors and are now being sued by the taxing authorities to pay taxes, interest and penalties. We therefore urge you to consult us regarding classification of workers as independent contractors.

ABOUT THE AUTHOR

Paul Maricle is a lawyer at Coan, Payton, & Payne, LLC, a Colorado-based law firm. In July 2015, he was appointed Honorary Consul for the Federal Republic of Germany in recognition of his active engagement in the German community in Colorado for 30 years.

Mr. Maricle is a founding member of the German American Chamber of Commerce – Colorado Chapter and has served on its board for over 25 years. Mr. Maricle's law practice focuses on representation of German companies doing business in the U.S.

Throughout his legal career, Paul Maricle has advised small and medium-sized corporate clients in many aspects of commercial, corporate and business law including transnational commercial transactions. He has extensive experience in areas including stock and asset purchase agreements, distribution agreements, licensing agreements, employment agreements, corporate governance, real estate leases, export regulation, commercial arbitration, commercial litigation, collections and bankruptcy matters.

Mr. Maricle has been rated AV® Preeminent by Martindale-Hubbell's Peer Review Ratings. For more information about the ratings, please visit www.martindale.com. He has also been recognized by his peers as a Colorado Super Lawyer.

Mr. Maricle received his undergraduate degree in Modern Foreign Languages (German) cum laude with departmental honors from Washburn University of Topeka and his juris doctorate degree from Washburn University Law School. He studied at the Friedrich-Wilhelms Universität in Bonn and worked for the Bundesverband der Deutschen Industrie e.V. in 1982. He speaks fluent German.