

# MILLER CANFIELD

DOING BUSINESS IN NORTH AMERICA

VOLUME ONE: **United States** ■



# MILLER CANFIELD

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The information in this booklet provides an overview of the fundamental legal considerations to be addressed when acquiring or establishing a business in the U.S.

The content is intended to summarize some of the pertinent provisions which apply and is not intended as specific legal advice. Readers are well advised to seek the counsel of specialist professionals in their home states to advise on compliance with the laws and identify the many planning opportunities.

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# Table of Contents

- Types of Businesses and Operations..... 1
- Establishing A Business..... 3
- Labor and Employment..... 4
- Immigration..... 9
- Payments To Foreign Persons.....11
- Customs..... 12
- Federal Income Tax..... 14
- Sales, Use and Other Taxes..... 19
- Financing the U.S. Operation..... 20
- Economic Development Incentives.....23
- Product Liability..... 25
- Litigation..... 30
- Antitrust..... 33
- Dissolving A Business.....36
- Meet the Law Firm of Miller Canfield..... 39



## Types of Businesses and Operations

### Overview

In choosing to conduct business in the United States, businesses based in other countries should keep in mind that business entities are formed under the laws of each of the 50 states, not the U.S. Government. The choice of the type of legal structure will be dependent on a number of factors discussed below. Legal and financial advisors should be consulted in making this decision. In general, the choice of type of entity will come from among the following:

- Corporations
- Limited Liability Companies
- Partnerships, general or limited
- Various joint venture arrangements that can be structured with any of the above-listed entity types
- Branch Operations

There are some key issues to consider in arriving at an appropriate arrangement. They include:

- Limited liability protection and risk management
- Funding and financing
- Public image
- Income and other taxes
- Repatriation of capital and profits

### Corporations

A corporation is a legal entity (separate from its shareholders) in which the shareholders' liability for the debts and obligations of the corporation is limited to the shareholders' investment in the corporation. Corporations are incorporated under state law.

#### *Formation and Organization*

A corporation is formed by the filing of the articles of incorporation or certificate of incorporation (depending on the state), with the appropriate state office in the state in which the corporation is to be domiciled. A corporation organized in a particular state is entitled to carry on business in the state of incorporation, and must be registered as a foreign corporation in any other state in which it wishes to carry on business and/or protect its trade name.

The articles of incorporation broadly provide the purpose and structure governing the corporation's existence. The corporation's bylaws lay out more detailed and routine governance matters. Only the articles of incorporation are filed with any state office, but some states require annual reports that list the corporation's directors or officers.

#### *Capitalization*

A corporation is usually capitalized initially through the sale of stock to the shareholders of the corporation. A corporation may later sell additional securities to investors in order to raise additional capital. Such securities normally include equity securities (either common or preferred stock) or debt securities (either debentures or convertible notes). Any issuance of securities must comply with federal and state securities laws, necessitating care to avoid violating any applicable laws and regulations.

Generally, the board of directors must authorize the issuance of any securities, debt or equity. Securities may be issued in consideration of any tangible or intangible property or benefit to the corporation, including cash, promissory notes or services performed or to be performed on behalf of the corporation.

#### *Governance and Management*

A corporation has two governing bodies - shareholders and a board of directors. The shareholders meet to elect the board of directors, and then periodically to approve certain matters as may require shareholder approval under state law or the articles of incorporation. The business and affairs of a corporation are generally managed by a board of directors. The board of directors then appoints the officers of the corporation (e.g., President, Secretary, Treasurer), who usually run the day-to-day operations. The directors of a corporation are elected by its shareholders, generally by a plurality of those shareholders present at a shareholders meeting or voting by written consent in lieu of a shareholders meeting (where permitted by statute and the corporation's organizational documents). A corporation may opt for cumulative voting where shareholders apportion their votes among director candidates, which may provide minority shareholders with representation on the board of directors.

Directors generally serve one year terms. A corporation may, however, opt for a "staggered" or classified, board of directors. A staggered board is divided into classes of directors with the election of directors to be on a rotating basis based on their class, which results in the election of only a portion of the total board each year.

### ***Distributions to Shareholders***

Subject to certain statutory limitations, a corporation, through its board of directors, may distribute capital from the corporation to its shareholders. Generally, earnings and distributions to a certain class or classes of stock are distributed to all shareholders of such class or classes in accordance with their respective equity stake in the corporation. However, different classes of stock are permitted, including "preferred" shares, which generally receive preferential treatment to distributions, liquidation and may bear interest. Distributions made to shareholders of a corporation are taxable income attributable to the recipient shareholder. In general, corporations may only make such distributions when they are solvent, meaning that they have a positive net worth.

### ***Shareholder Liability***

Shareholders of a corporation are generally shielded from personal liability for the obligations of the corporation. Generally, a shareholder's liability for the debts and obligations of the corporation is limited to the shareholder's equity in the corporation. Under certain extraordinary circumstances, however, a court may decide to "pierce the corporate veil" in order to impose liability on shareholders. One reason a court may take such action is a corporation's failure to adhere to certain corporate formalities, such as corporate record keeping, holding board and shareholder meetings, electing officers and directors of the corporation, and commingling corporate assets with non-corporate assets. Another is that one or more shareholders are operating the corporation as though it were a personal asset.

### ***Extraordinary Actions***

Although the board of directors of a corporation is empowered to bind the corporation on most matters, there are certain actions which statutorily require the approval of the shareholders in addition to the board of directors. The most common examples include mergers, sales of all or substantially all of the assets of the corporation, and dissolution of the corporation.

### ***Taxation***

Corporations are taxed at the entity level for income attributable to the corporation, which is imposed by federal law and by many states and some municipalities. In addition, a corporation's shareholders are taxed for any dividends or other distributions made to them from the corporation.

## **Partnerships**

Partnerships are governed by state law. A partnership can either be a general partnership or a limited partnership. A limited partnership may provide certain partners with limited liability protection, as would be the case with shareholders of a

corporation. At least one partner of a limited partnership must be a general partner (frequently, either a limited liability company or a corporation is the form of organization selected for this purpose) and the limited partners cannot have control over the management or operation of the business.

A general partnership (called a co-partnership in some states) means that each partner is jointly liable for all debts or other obligations of the general partnership. There is no limitation on a general partner's liability, meaning that the personal assets of a general partner may be at risk in the event the partnership's assets are insufficient.



Overall, creation of a partnership requires little or no formality. Nor does it require a written agreement, although a written partnership agreement setting forth the partners' intention to establish a partnership and their agreement on the terms of the business relationship is highly advisable.

It is common for a partnership to appoint a managing partner and to restrict the authority of the partners other than the managing partner, because each partner is fully liable for the debts and obligations of the partnership if it is unable to pay them. This means that the partnership's debts and obligations can be recovered from a partner's personal assets to the extent the partnership's assets are not sufficient. A partner is also personally liable for the acts and omissions and other wrongdoing of its partners when such partners are either acting in the ordinary course of business or with partnership authority.

Most partnership agreements also specify the allocation of profits and losses among the partners. State statutes generally permit an allocation of profits and losses that is not based on the partners' capital contributions if agreed upon in a written partnership agreement.

Partnerships are disregarded, or tax pass-through entities, for tax purposes.

As is the case with limited liability companies, only the certificate of formation (or its equivalent depending on the state in which the partnership is formed) needs to be filed with the state of formation.

## **Limited Liability Companies**

Limited liability companies (or LLCs) combine some of the most attractive characteristics of corporations and partnerships. Generally, the choice of an LLC provides for greater organizational and operational flexibility, fewer formalities and more favorable tax treatment than corporations, while maintaining the limited liability protection afforded to corporations.

One of the most beneficial characteristics of an LLC is that they are treated as a partnership for tax purposes, yet the owners of an LLC are afforded limited liability in the same way shareholders of corporations are. As a “disregarded entity,” all taxable income, gains, losses, credits and deductions pass through to the constituent members of the LLC, rather than being imposed on the LLC entity itself. In addition, liability for the debts and obligations of the LLC attach to the entity rather than the members of the LLC.

### ***Formation and Organization***

LLCs are formed by the filing of a certificate of formation or articles of organization (depending on the state) with the appropriate state officials.

All governance matters are provided by statute or in a written operating agreement. Operating agreements typically also contain the members’ agreement on issues regarding capitalization, admission and withdrawal of members, voting matters and management of the LLC, and treatment of profits and distributions to members. Only the certificate of formation or the articles of organization, as the case may be, are required to be filed with the state of formation.

### ***Capitalization***

Generally, statutes permit members to contribute tangible or intangible property or services in order to capitalize the LLC. Contributions may include cash, real or personal property, services or written undertakings to provide any of the above in the future.

### ***Management***

An LLC can be managed by its members or by a manager appointed as provided in the operating agreement. As a general rule, if the formation documents do not specify, the LLC will be managed by its members. No matter how the LLC is managed,

members typically retain their right to vote on certain matters, including dissolution, mergers, and amending the formation document.

Managers are generally required to act in good faith, with the care an ordinarily prudent person in a similar circumstance would use. Assuming that this standard is complied with, a manager generally will not be liable for its acts or omissions to act during their tenure as a manager of the LLC. Similar to the protection afforded a director of a corporation, the organizational documents of the LLC may limit or altogether eliminate the monetary liability of a manager of an LLC or its members for a breach of the manager’s duty.

### ***Distributions***

All profits and losses, or other distributions are made in accordance with the terms of the operating agreement. Other times, LLC operating agreements provide for a “waterfall” for distributions to be made to certain classes of interests. Generally, if not covered in the operating agreement, the profits and losses, or other distributions will be allocated in accordance with the member’s pro rata equity stake in the LLC.

## **Establishing A Business**

### **Incorporation**

A corporation, partnership or limited liability company can be established and organized in a matter of a day or two.

Companies are established and incorporated on a state and not on a national level. Popular states for incorporation include the state in which the business will have its principal place of business or the State of Delaware. Once incorporated, a company can qualify to do business in other states within the U.S. by filing the appropriate forms.

### **Taxes and Related Matters**

To conduct business in the U.S., a company will need to obtain a federal Employer Identification Number (EIN). A company obtains an EIN using Internal Revenue Service Form SS-4. A company may need to obtain a separate state taxpayer identification number in the state in which it has its principal place of business and perhaps also in other states in which it conducts business.

U.S. individuals who live in or carry on business in the U.S. and file individual tax returns should apply for a U.S. Social Security Number. Individuals who are not authorized to work in the U.S. will obtain a Social Security Card that states that they are not authorized to work without authorization by the U.S. Bureau of Citizenship and Immigration Services.

### Workers' Disability Compensation and Unemployment Compensation

A company having employees will need to obtain workers' disability compensation insurance coverage in each state in which employees are located. This coverage provides compensation to an employee in the event that the employee is injured on the job.

A company will also need to make payments into the unemployment compensation system in each state in which employees are located.

A company also needs to pay Federal Unemployment Tax to the U.S. government. Unemployment compensation coverage provides payments to employees who lose their jobs through no fault of their own.

Independent payroll and benefit agencies are available to assist companies with the establishment and administration of employee payroll and benefits.

### Bank Accounts and Licenses

Corporate bank accounts can be arranged quickly. To open a bank account, a company will need to provide the bank with copies of the company's incorporation documents, the company's Employer Identification Number and a resolution authorizing the company to transact business with the bank.

A company may also be required to obtain a license for doing business in the places in which it operates. These are normally obtained on a state or local level. Building permits are required for the construction, expansion or alteration of any building to ensure compliance with zoning laws and building codes. A certificate of occupancy will generally be needed before a company can move into commercial office space that it is leasing.



### Employment Regulations Overview

Labor and employment law in the United States consists of multiple federal and state statutes, administrative regulations, and judicial decisions, which in whole or in part encompass virtually every area of the employer-employee relationship.

### Pre-Hire Issues

When hiring employees, employers must ensure that they do not ask any unlawful questions in their applications and interviews. For example, an employer may ask an applicant if she/he is older than 18 years of age, but it should be careful about asking the applicant's age since such inquiries are closely scrutinized. An employer is also generally prohibited from asking about an employee's physical or mental condition prior to making an offer of employment. Drug testing, however, is generally legally permissible, provided certain procedures are followed.

Employers may also choose to perform reference and/or criminal background checks on applicants. The Fair Credit Reporting Act (FCRA) prohibits a company from obtaining or using a "consumer credit report" in connection with decisions about employment unless it first obtains the written consent of the individual before the report is ordered and gives written notice to the individual that a consumer report may be obtained for employment purposes. In certain circumstances, the consent and notice requirement need not be in writing to be effective and in those cases, the employer must also notify the applicant of his rights under the FCRA. Therefore, an employer obtaining information on an applicant's (or current employee's) "character, general reputation, personal characteristics," from third parties to whom it pays a fee (as opposed to conducting its own background check) must comply with the specific notice and consent requirements. Before taking any adverse action based in whole or in part on the report, the employer usually must also provide the individual with a copy of the report and an opportunity to dispute the report's accuracy.

The New Hire Reporting Act requires employers to report information on newly hired employees to a designated state agency. Generally, companies must report this information within 20 days of the hire. While some states also require the reporting of independent contractors, federal law does not require it. The Immigration Reform & Control Act (IRCA), applying to all U.S. employers, prohibits the employment of individuals without evidence of U.S. work authorization, and goes even further to prohibit employers from continuing to employ individuals if the company subsequently learns that the

employee is an “illegal alien” (i.e., an individual with no legal employment status in the U.S.). Employers must complete Employment Verification Forms (Form I-9) for all employees hired or rehired after November 6, 1986, within three days of the date of hire. Employers must retain I-9 Forms for at least three years of the date of hire or at least one year after the termination date, whichever comes later, else face civil and criminal penalties. In 2007, U.S. Citizenship and Immigration Services (USCIS) amended Form I-9 and employers must use the updated form to verify employment eligibility of all new hires or re-verifications after December 31, 2007.

In virtually every state, employees are presumptively employed “at will.” This means that either the employer or the employee may terminate the employment relationship at any time, for any reason that is not prohibited by law. Employers who wish to maintain the “at will” status of their employees must be sure that they do not make representations to applicants contrary to this standard (e.g., that the employee will only be terminated for “good cause”). While not required, a written “at will” policy helps to preserve an employee’s “at will” status.

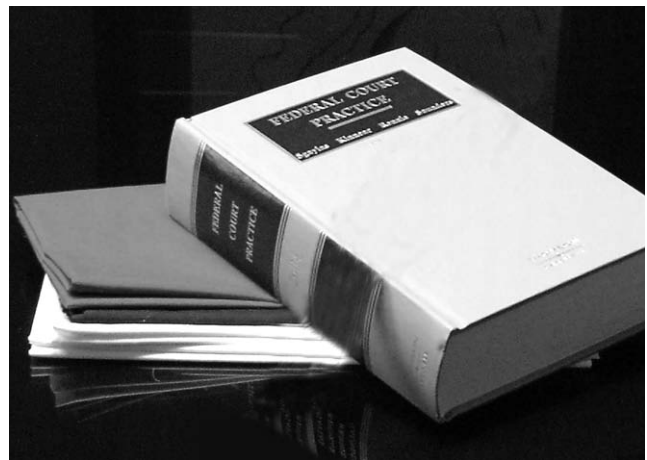
### **Record Keeping Requirements**

Federal and state laws require employers to maintain a wide array of records regarding their applicants and employees. A non-exclusive list of records that must be retained includes: applications, records of promotion, demotion or termination, payroll records, tax information, documents regarding unemployment and worker’s disability compensation, and hazardous materials and occupational noise exposure.

### **Discrimination, Harassment and Retaliation**

There are a number of federal laws prohibiting workplace discrimination against protected individuals in regard to application procedures, hiring, promotion, termination, compensation, job training and other terms, conditions, and privileges of employment. Title VII of the Civil Rights Act of 1964 prohibits discrimination on the basis of sex, race, color, national origin and religion. Congress amended Title VII by enacting the Pregnancy Discrimination Act which includes discrimination on the basis of pregnancy within the category of unlawful gender discrimination. Title VII applies to employers with 15 or more employees..

Congress also enacted the Age Discrimination in Employment Act (ADEA) to prohibit age discrimination against employees 40 years of age or over. The ADEA applies to employers who have 20 or more employees. Similarly, the Americans with Disabilities Act (ADA) typically applies to employers with at least 15 employees and prohibits discrimination on the basis of a disability. Under the ADA, a covered employer may be found to “discriminate” if the employer fails to provide reasonable



accommodation that would enable an otherwise qualified employee with a disability to perform the essential functions of the job, unless the employer can demonstrate that the accommodation poses an undue hardship. Pursuant to the Equal Pay Act, which is a part of the Fair Labor Standards Act (FLSA), employers shall not engage in sex-based wage discrimination between men and women in the same establishment who are performing under similar working conditions. The Equal Employment Opportunity Commission (“EEOC”) administers and enforces these laws and promulgates interpretative regulations.

States have their own anti-discrimination statutes paralleling the federal laws above and also prohibiting workplace discrimination. Often, state laws include additional protected categories and require a lower number of employees for applicability to employers. State fair employment agencies, the EEOC, or both administer and enforce these laws.

Federal and state laws also prohibit harassment based on any protected category, such as sex or race. Harassment is generally defined as unwelcome conduct or communication based on a protected category, which is severe and pervasive and has the purpose or effect of substantially interfering with an individual’s employment. Not only are employers prohibited from engaging in unlawful harassment, but they also have a duty to prevent unlawful harassment by others in the workplace, including coworkers and customers.

Federal and state laws also prohibit retaliation against individuals for exercising their rights under these statutes, such as filing a discrimination claim.

### **Compensation and Fringe Benefits**

Federal and state statutes directly affect the payment of salary, wages and fringe benefits to employees and govern child labor regulations and equal-pay provisions. The federal Fair Labor Standards Act (“FLSA”) sets minimum wage and overtime pay



requirements. Federal minimum wage and overtime pay standards are set and enforced by the U.S. Department of Labor's ("DOL") Wage and Hour Division. On May 25, 2007, the FLSA was amended to increase the federal minimum wage in three steps: to \$5.85 per hour effective July 24, 2007; to \$6.55 per hour effective July 24, 2008; and to \$7.25 per hour effective July 24, 2009. Currently, FLSA requires overtime pay at a rate of not less than 1-1/2 times the regular rate of pay after 40 hours of work in a workweek. The FLSA provides an exemption from both minimum wage and overtime pay for employees employed as "bona fide executive," "administrative," "professional," "outside sales employees," and certain "computer employees." Many states also have minimum wage and overtime laws. In cases where an employee is subject to both the state and the federal minimum wage and overtime laws, the employee is entitled to the more stringent standard.

The federal Family and Medical Leave Act ("FMLA") provides eligible employees of covered employers the right to take up to 12 workweeks of unpaid leave in a 12-month period for the birth and care of a newborn child of the employee, for placement with the employee of a child for adoption or foster care, to care for an immediate family member (spouse, parent or child) with a serious health condition, or when the employee's own serious health condition makes the employee unable to perform his or her job. On January 28, 2008, the National Defense Authorization Act for FY 2008 (NDAA) amended the FMLA to permit a "spouse, son, daughter, parent, or next of kin" to take up to 26 workweeks of leave to care for a "member of the Armed Forces, including a member of the National Guard or Reserves, who is undergoing medical treatment, recuperation, or therapy, is otherwise in outpatient status, or is otherwise on the temporary disability retired list, for a serious injury or illness."

A "covered employer" is one with 50 or more employees during 20 or more weeks in the current or previous calendar year. To be an "eligible employee" an individual must have worked for the employer for at least 12 months, have worked at least 1,250 hours during the year preceding the start of the leave and be employed at a worksite where the employer employs at least 50 employees within a 75 mile radius. Nothing in the FMLA supersedes any provision of State or local law that provides greater family or medical leave. In addition, nothing in the FMLA prevents an employer from providing more generous benefits. Rights granted by the FMLA may be enforced by employees in court, individually or as a class action, or by the DOL. Employee benefits and plans are subject to extensive regulations via the Employee Retirement Income Security Act ("ERISA"), the Internal Revenue Code ("IRS"), the Consolidated Omnibus Budget Reconciliation Act ("COBRA"), the Health Insurance Portability and Accountability Act of

1996 ("HIPAA") and other federal and state laws and regulations.

ERISA regulates both welfare benefit and pension plans and sets forth standards and requirements for fiduciary responsibilities, disclosure, participation, vesting, accrual and the like. It also has a civil enforcement mechanism for employees. State law causes of action, however, are completely preempted by ERISA. Responsibility for ERISA is divided among three federal agencies: the IRS (participation, benefits accrual, vesting and funding); DOL (reporting, disclosure, fiduciary obligations and civil enforcement); and Pension Benefit Guarantee Corporation (administer, enforce and fund plan termination insurance programs).

Under COBRA, employees and their dependents are allowed to maintain company medical insurance plans in situations where they would otherwise lose coverage. This right may be triggered if, for example, there is a termination, layoff, divorce or death. The employees and/or their dependents may continue their existing insurance coverage by paying the company's cost for the insurance plus a minimal administrative fee. Eligible employees and dependents can extend their coverage for up to 18 months in most cases. COBRA applies to companies with 20 or more employees at work for more than 50% of the workdays in the prior year.

Companies in the U.S. that utilize group plans are prohibited from adopting eligibility rules based upon health related factors and are prohibited from charging higher premiums to those with certain health conditions. HIPAA applies to any company or insurance carrier that provides group health insurance to two or more current employees starting on or after June 1, 1997. HIPAA also applies to individual policies. The Act prevents companies from applying any pre-existing condition exclusion to an employee who was covered under a prior company's plan within 63 days of the time of hire.

The Health Maintenance and Organization Act ("HMO") permits an employer to elect one or more qualified HMOs in the health plan alternatives it offers to its employees, provided it meets the following conditions: the employer (1) employs 25 or more employees, (2) is subject to the minimum wage requirements of the FLSA, or would have been required to pay a minimum wage, except for the exemptions provided in the FLSA, (3) already provides health insurance benefits to its employees, and (4) a qualified HMO is available where at least 25 of its employees reside.

### **Traditional Labor Laws**

The National Labor Relations Act ("NLRA") regulates the relationship between private-sector employers, unions, and employees and is administered by the National Labor Relations

Board (“NLRB”). Among other things, the NLRB conducts representation elections to determine if employees will be represented by a union, decides whether the composition of bargaining units need to be clarified, and investigates and prosecutes unfair labor practice charges. The NLRB processes only those charges of unfair labor practices and petitions for employee elections that are filed with the NLRB in one of its 51 Regional, Subregional, or Resident Offices. States have their own similar statutory framework regulating the relationship between public-sector employers, unions, and employees. Under federal and state law, it is unlawful to discriminate or retaliate against employees engaging in protected concerted activity. After a union is certified or recognized as the collective bargaining representative of employees, the employer must meet with the union to negotiate over terms and conditions of a collective bargaining agreement. Collective bargaining agreements need not conform to any particular format, but typically they specify management’s rights, wage rates in each job classification, hours, breaks, meal times, fringe benefits, that union dues will be deducted from employee paychecks, the employer’s right to discharge employees only for just cause, a grievance procedure that leads to final and binding arbitration and other terms and conditions of employment. Both sides possess significant economic weapons to force the other to accede to its demands and break an impasse. For example, an employer may lock out employees and the union may exercise its right to strike the employer.

## Layoffs

U.S. law requires certain companies to give employees a 60-calendar day advance notice of planned layoffs in cases of mass layoffs which are expected to last for six months or longer. The Worker Adjustment and Retraining Notification Act (“WARN”) applies to companies with 100 or more full-time employees or the equivalent (i.e., any combination of 100 workers or more who work a minimum of 4,000 hours per workweek, excluding overtime). Under the WARN Act, a mass layoff means a reduction in force which is not a result of a plant closing and results in an employment loss at a single site of employment during any 30-day period for either (1) a loss of 50 jobs (excluding any part-time employees) that affects 1/3 of the employees (excluding any part-time employees) or (2) a loss of at least 500 employees (excluding any part-time employees). When there are multiple layoffs, then any layoff occurring within 90 days of the latest layoff is taken into consideration to determine if WARN notice is required, unless the employer demonstrates that the employment losses are the result of separate and distinct actions and causes and are not an attempt by the employer to evade the requirements.

A company’s failure to provide notice results in liability for up to 60 days for back pay plus reimbursement for medical or other expenses which would have been covered during the time period. Under WARN, newly hired workers (i.e., workers employed less than 120 days at the company) can receive back pay and lost benefit coverage only up to 1/2 of the days actually worked. The company may be subject to a fine for failure to provide the required notice, as well as attorney’s fees to the complainant/plaintiff.



## Workplace Safety

Companies in the U.S. must maintain a safe working environment for their employees. Under the Occupational Safety and Health Act (“OSHA”), any employer engaged in a business that affects interstate commerce has a general duty to maintain a safe place to work and to comply with all OSHA regulations issued by the DOL. OSHA requires that employers maintain certain records regarding work-related injuries and that certain reports be filed in cases of accidents causing severe injury, or especially in accidents resulting in death. OSHA officials have the right to enter the company’s facility in order to check compliance with safety standards, and to review records.

OSHA also protects employees who report unsafe workplaces or safety hazards, employees who participate in OSHA proceedings, and employees who attempt to exercise their rights (e.g., refuse to work with unsafe machinery) under the Act. Employees who feel that they have been discriminated against under OSHA may complain to the DOL and in some states there are also whistleblower claims available to them for relief.

Under OSHA, each state may develop a state occupational safety and health plan that is at least as effective as the federal plan. Once the state plan has been submitted and approved by the DOL, that plan then likely preempts the federal plan, providing the state with exclusive jurisdiction over occupational safety and health within its territory.

## **Miscellaneous Statutes**

Other regulations enacted to both protect the labor force and to take the place of public insurance are mentioned here, although this is not an all-inclusive list.

### ***Workers' Disability Compensation***

Each state has a statutory scheme that requires employers to provide wage and medical benefits to an employee incurring a disabling injury during the course of employment without regard for fault. Employers must either purchase worker's disability insurance or meet certain requirements to be self-insured.

### ***Unemployment Insurance***

States have unemployment insurance laws that provide for the contribution of unemployment taxes, reimbursement of benefits and ultimate payment of unemployment benefits to eligible claimants. Since all 50 states must meet federal guidelines, unemployment insurance systems across the country are very similar.

### ***Whistleblowers' Protection Act***

Many states have statutes protecting employees who report a violation or suspected violation of any local, state or federal law. The protection also typically extends to employees participating in hearings, investigations, legislative inquiries or court cases.

### ***Uniform Services Employment Reemployment Rights Act of 1994 ("USERRA")***

This statute applies to all employers regardless of size, USERRA covers every individual in the United States who serves or has served in the uniformed services. The statute ensures that those who serve their country can retain their civilian employment and benefits and can seek employment free from discrimination because of their service. All employers must grant reservists called into active duty and employees who voluntarily enlist a leave of absence for the duration of such duty for a period not to exceed 5 years. Upon expiration of the leave, an employer must restore the individual to her or his former position or a "position of like seniority, status, and pay," with limited exception. USERRA is administered by the DOL, through the Veterans' Employment and Training Service. USERRA also requires that, upon return from active duty, the individual be provided the opportunity to qualify for any promotion that arose during his or her absence.

### ***Drug Free Workplace Act***

Federal contractors and recipients of federal grants are required to ensure a drug-free workplace. A companion law requires drug and alcohol testing for all transportation industry employees who have safety-sensitive functions.

### ***Federal Bankruptcy Code***

This law prohibits the termination of an employee or discrimination against an individual because that person has filed for bankruptcy or because that individual's spouse/parent/child has filed for bankruptcy.

### ***Consumer Credit Protection Act***

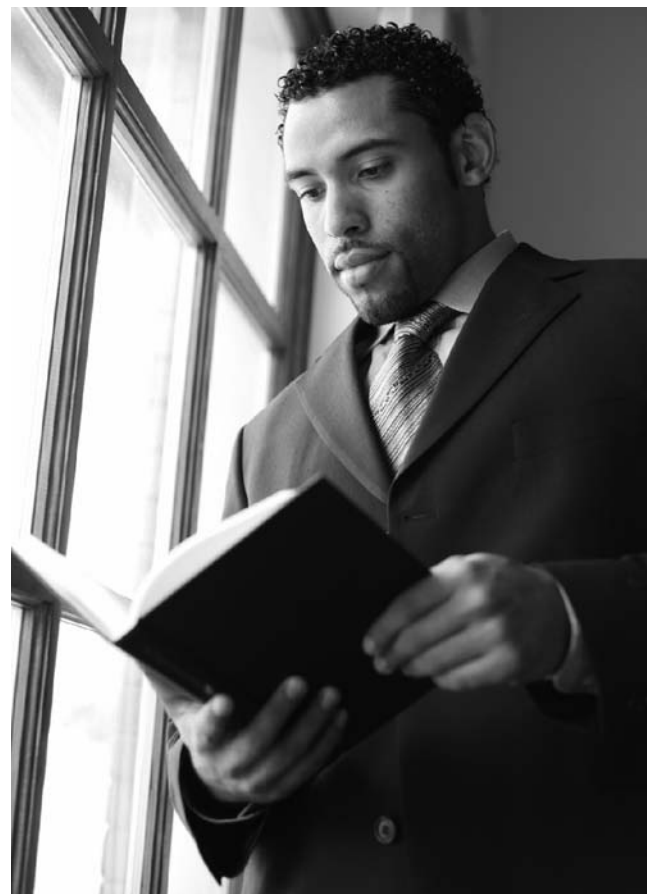
This places limits on the amount of wages that a creditor may garnish. There is a 25% of disposable income limit on garnishments, and further protection for lower-paid, part-time workers.

### ***Invasion of Privacy***

Federal employees have a right of privacy in certain circumstances pursuant to the U.S. Constitution. Some states also have statutes protecting private employee privacy rights. Where such statutes do not exist, many states recognize common-law invasion of privacy rights such as intrusion, false light, public disclosure of private facts and appropriation.

### ***Miscellaneous Common Law Action***

Many states recognize additional common law actions, such as defamation, tortious interference with contract, and intentional infliction of emotional distress.



## Immigration

### Overview

U.S. immigration law is federal law and, as such, it does not vary from state to state. Immigration laws are now enacted, implemented, administered and enforced by the Department of Homeland Security. U.S. Citizenship and Immigration Services (USCIS) and U.S. Customs and Border Protection (USCBP) are the primary agencies of the Department of Homeland Security that approve and admit foreign nationals for employment in the U.S. Companies interested in employing foreign nationals must first determine if the individual requires sponsorship for U.S. work authorization; then, they must determine whether the individual and the work qualify for work authorization. Under the U.S. Immigration and Nationality Act, there are different eligibility requirements and documentation requirements in employing a foreign national. The most common employment relationships and a broad overview of the visa categories that apply to those relationships are explained below.

### Business Visitors

Foreign companies may send their employees to the United States upon invitation by a U.S. company without requiring a work visa if the foreign national will enter the U.S. to engage in a business activity that does not involve gainful employment in the U.S. Acceptable activities under this visa category may, in appropriate circumstances, include: to attend meetings or conferences; to consult with business associates; to negotiate contracts; to investigate and identify business locations and/or opportunities; to participate in litigation; to attend or participate in professional or business conferences or seminars; and to engage in independent (market) research which principally benefits the foreign employer. These foreign individuals must apply for Business Visitor (B-1) visas at the U.S. Consulate in their home country. B-1 visas are issued for the time required by the U.S. company or foreign company, with a maximum initial admission period allowed of six months. B-1 status can generally be extended for a maximum period of six months while in the U.S. B-1 visa holders may also change their status to another visa category while in the U.S.

Some countries participate in the Visa Waiver Program and nationals from those countries may enter the U.S. in Visa Waiver status for trips of up to 90 days or less provided that their intent is the same as that required for the B-1 visa. While the Visa Waiver has the advantage of not requiring advanced processing through a U.S. Consulate, thereby speeding up the process of getting the foreign individual into the U.S., the biggest disadvantage of the Visa Waiver Program is that foreign individuals who enter in that status may not seek to extend their stay or to change their status to another visa category while in

the U.S. It should also be noted that Canadian citizens are exempt from having to obtain a B-1 visa prior to making a business visitor entry.

### U.S. Sponsored Employment

The majority of work authorizations issued to foreign nationals are those in cases where the U.S. companies seek to sponsor foreign nationals for employment in the U.S. In these cases, individuals cannot apply for U.S. employment authorization directly with the USCIS without the sponsorship (i.e., offer of employment and sponsorship for a work visa) of a U.S. company.

Companies seeking to employ foreign nationals in the U.S. are generally first required to apply with the USCIS, and sometimes also with the U.S. Department of Labor (DOL) depending on the visa category, to obtain work authorization for the foreign national. Once the U.S. company obtains an approval for work authorization, the foreign national (with the exception of Canadian citizens) must then apply for a visa at the U.S. Consulate in his/her home country, or in some cases in the country of their residence. Canadian citizens can apply for admission with a USCIS approval for work authorization directly at U.S. ports of entry (except for E visa status).

The most widely utilized work visa categories are the following:

#### *H-1B Specialty Occupation visas*

H-1B nonimmigrant worker visas are designed for foreign nationals who are employed by a U.S. company and enter the U.S. to perform professional services in a specialty occupation.

To qualify for H-1B status, the U.S. position must be one that requires, as a minimum, a U.S. Bachelor's degree or its equivalent. The foreign national must also hold the equivalent of a U.S. Bachelor's degree in the specialty area where she/he will be employed in the U.S. In some cases, the foreign national is also required to hold an applicable license in the state where they will be employed. Companies must first obtain a prevailing wage determination. The prevailing wage is determined by the DOL on the basis of the occupational category and the metropolitan statistical area in which the employee will be working. Second, the company has to obtain certification of a Labor Condition Application (LCA) from the DOL. Then, the company has to post the LCA at the worksite, and must maintain LCA files for all H-1B employees. Once the certified LCA has been obtained, the company may then apply with the USCIS for the H-1B nonimmigrant approval. The USCIS sets an annual numerical cap on the number of new H-1B visas issued, therefore, the H-1B status may not always be available during the fiscal year (this does not apply to extensions of H status or change of employer where the individual currently holds H status). H-1B status is generally issued for three years,

and can be extended for a maximum period of stay in that category of six years.

### ***Intracompany Transfer or L-1 Visas***

L-1 (Intracompany Transfer) status is utilized by companies wishing to transfer their employees from a foreign business entity to a U.S.-based parent company, subsidiary, affiliate, or branch office. The foreign employee must have been employed with the foreign business entity for at least one year within the last three years immediately prior to being transferred to the U.S.

There are two categories of L-1 status, those for executive or managerial employees (L-1A visas) and those for specialized knowledge employees (L-1B visas). Intracompany transfer employees are generally not required to demonstrate that they hold the equivalent to a U.S. Bachelor's degree in order to qualify for this visa category. However, the company must provide documentation to the USCIS to demonstrate the employee qualifies in either category in order to transfer the employee to the U.S. in a temporary position. L-1 visas are issued for either one (new office) or three years (existing office) the first time an employer applies for the L-1 status with the USCIS. Canadian citizens may apply for L-1 status directly at U.S. ports of entry and, upon approval, are admitted into the U.S. for work immediately. L-1A employees are authorized a maximum period of stay of seven years in that status, while L-1B employees are authorized a maximum period of stay of five years.

### ***Treaty Trader or Treaty Investor Visas***

Under international trade and commerce treaties between the U.S. and other nations, certain foreign companies can apply for U.S. work authorization directly with the U.S. Consulates within their country. These are the category of Treaty Trader (E-1) or Treaty Investor (E-2) visas. The E-1 visa category is utilized by companies engaged in substantial trade with the U.S. An employee who seeks to enter the U.S. in E-1 status must qualify as one who has executive or supervisory duties, or who possesses essential skills needed by the company in the U.S. The E-2 visa category is utilized by foreign companies who substantially invest in a U.S. company. An employee who seeks to enter the U.S. in E-2 status must be fulfilling an important role in the U.S. company, either as the investor or as a manager, or the employee must be specially trained in the specialty area, or must be highly qualified and necessary for the development of the investment in the U.S. Most E visas are issued by the U.S. Consulate for a period of five years, after which they can be renewed with documentation that the need still exists for that individual to hold E status in the U.S. In addition, in order to obtain either E-1 or E-2 nonimmigrant status, the company and individual must meet the following qualifications:

- 1) there must be a treaty of commerce and navigation, or a bilateral investment treaty between the U.S. and the country of nationality of the foreign company and/or investor;

- 2) the company (i.e., those who ultimately own the company) or the individual engaging in trade or investment in the U.S., must have the same nationality as the treaty country; and,

- 3) the individual applying for the E visa at the U.S. Consulate must be a citizen of the same treaty country.

### ***NAFTA Company Sponsored Permanent Residency***

Companies in the U.S. may also sponsor their professional foreign employees for Legal Permanent Resident ("Green Card") status. Sponsoring an employee for Legal Permanent Residence in the U.S. is a privilege, and not required of the company by either state or federal employment or labor laws. The success and processing time of the petition is largely determined by the occupational category of the foreign employee and by the state of the U.S. economy at the time of application.

With respect to most employment-based green card categories, a company must first apply for Labor Certification with the U.S. Department of Labor, under a system called PERM, before obtaining an immigrant visa and Legal Permanent Residency status for their employee from the USCIS. The Department of Labor requires documentation to show that the company is unable to find a qualified candidate within the U.S. labor force to fulfill the position. Some occupations are easier than others to certify, but the whole process may take years until the individual obtains a green card from USCIS.



## Payments To Foreign Persons

### Proprietorships and Branches

No additional tax is payable if an individual proprietor simply takes funds back to a foreign country after paying U.S. personal income tax.

No additional tax is payable if a branch of a Foreign Person sends funds to the Foreign Person (after apportioned and branch taxes have been paid).

However, any time that a U.S. taxpayer makes a payment (of any nature) to a non-resident, U.S. tax and concomitant withholding obligations may be applicable.

### Dividends

#### *Portfolio Dividends*

A withholding tax of 30% will generally apply to portfolio dividends though this rate may be reduced under the applicable tax treaty. No U.S. tax treaty entirely eliminates U.S. tax on U.S. source portfolio dividends and the rate is seldom reduced below 15%.

#### *Non-Portfolio Inter-Corporate Dividends*

U.S. withholding on non-portfolio dividends is generally limited to 15%. However, a lower rate, 5% under the U.S. Model Tax Treaty, applies if the holder is a foreign corporation (resident in a treaty country) holding at least 10% of the voting stock of the payor corporation. Only direct stock ownership is considered in calculating the 10% holding though shares held by a fiscally transparent entity (e.g., a partnership or limited liability company) are considered to be held directly.

#### *Deductibility*

Dividends are not deductible from the taxable income of the U.S. company.

### Management Fees and Administrative Support Reimbursements

The U.S. Model Tax Treaty and most individual treaties exempt U.S. tax management fees paid to a Foreign Person. However, the Internal Revenue Service will examine the reasonableness of any such fees for any amount considered to be excessive in terms of what could have been obtained in an arms-length transaction being categorized as constructive dividends and taxed at the applicable dividend rate (see above). Expenses incurred in the foreign jurisdiction should be carefully analyzed to ensure that all expenses related to the U.S. operations, such as executive support, engineering services, technical support and services, marketing, advertising, etc. are being reimbursed to the Foreign

Person in terms comparable to those of an arms-length transaction.

Payments to Foreign Persons for services are generally deductible from the taxable income of the U.S. company.

### Executive Compensation

Executive compensation, including director's fees, received by a Foreign Person for employment duties performed in the U.S. will generally be taxable by the U.S. However, an almost universal tax treaty exception, commonly called the 183 day rule, exempts such compensation from U.S. tax if the:

- (1) Employee is present in the U.S. for less than 183 days of a year,
- (2) Compensation is paid by a non-U.S. employer
- (3) Expense of such compensation is not born by the U.S. entity.

In addition to the forgoing prerequisites for claiming the "183 day rule" exemption, individual treaties with several countries also impose different time and dollar limitations while others impose such limitations in the alternative. Reference to the individual treaty is vitally important as many contain a trap for the unwary: some allow 183 days in a given calendar year while others calculate based upon a consecutive 12-month period.

### Interest Payments

The U.S. Model Tax Treaty (and many individual treaties) exempts payments of interest to a Foreign Person from U.S. taxation. This exemption is far from universal however, and interest is often subject to a withholding tax of between 5 and 30 percent with 10 percent being the norm. The treaty exemption or rate reduction does not apply to interest attributable to a permanent establishment or fixed base in the U.S. Moreover, under certain individual treaties the exemption or rate reduction is also unavailable if the property producing the income is effectively connected with a fixed base in the U.S. from which the individual recipient performs independent personal services.

### Royalties

Royalties paid from the U.S. to a Foreign Person are generally subject to U.S. taxation at a reduced rate ranging from 5 to 30 percent with 10 to 15 percent being the norm. However, several individual treaties, such as those with the United Kingdom, Belgium, Germany and the Netherlands, provide a complete exemption from U.S. taxation. Most software, intellectual property and copyright royalties are exempt.

Royalty payments to Foreign Persons are generally deductible from taxable income of the U.S. company.

## Lease and Rental Payments

Payments to Foreign Persons for real property rentals in the U.S. are generally subject to a 30% withholding tax. However, as rental income typically has a variety of associated costs, the Foreign Person may elect to have such income treated as effectively connected income and thus subject to normal income taxation (see Royalties above).

Lease payments for tangible personal property are included in the definition of a Royalty as discussed above.

## Internal Revenue Service Reporting Obligations

### Dividends

Regardless of the applicable tax rate and whether such dividends were actually paid or constructively received, the U.S. company will be required to withhold and remit the U.S. tax on dividends paid to the Foreign Person. Additionally, the U.S. company will have to file IRS Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Corporations and IRS Form 1042-S Foreign Corporation's U.S. Source Income Subject to Withholding Annually.

### Royalties

All royalty payments to Foreign Persons must be reported annually by the U.S. company on IRS Form 5472, Information Return of a Foreign Owned U.S. Corporation.

### Management Fees

All management and service fee payments to Foreign Persons must be reported annually by the U.S. company on IRS Form 5472, Information Return of a Foreign Owned U.S. Corporation.

### Other

To claim a reduction of taxable rate or exemption from tax for any of the items discussed above, the Foreign Person must file IRS Form 8833, Treaty-Based Position Disclosure Statement, and must provide the U.S. company with the applicable of the following:

- (1) IRS Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (for beneficial owners to claim foreign status, beneficial ownership, and a reduced rate or exemption from withholding).
- (2) IRS Form W-8ECI, Certificate of Foreign Person's Claim for Exemption from Withholding of Income Effectively Connected with the United States (to claim foreign status, beneficial ownership and claim income is effectively connected with the conduct of a trade or business in the U.S.).

- (3) IRS Form W-8EXP, Certificate of Foreign Government or Other Foreign Organizations for United States Withholding (for foreign governments, international organizations, foreign central banks, or foreign tax exempt organizations to establish foreign status, claim beneficial ownership, and, if applicable, claim a reduced rate or exemption from withholding).

## Customs

### Overview

The U.S. Customs and Border Protection ("Customs") regulates imports into the United States as part of the Department of Homeland Security. Customs approves the clearance of imported goods and enforces trade and tariff laws. Customs also enforces the laws of other governmental agencies such as the Food and Drug Administration that may require special documentation at the time of import or impose additional obligations upon importers.

Imports include any shipment that physically enters the U.S. Customs Territory, including imports of equipment, manufacturing components, finished products, samples, consignments, returns, or items that have been previously imported into the U.S. The Customs Territory of the U.S. includes the States, the District of Columbia and Puerto Rico. An "importer" is commonly referred to as the "importer of record." An importer of record is the person or entity that Customs will primarily hold responsible for the payment of duties on imported merchandise and meeting other import requirements, although liability can be extended to other parties involved in the transaction.

The importer of record is responsible for using reasonable care to enter, classify and value imported merchandise, and provide any other information necessary to enable Customs to properly assess duties, collect accurate statistics and determine if the goods are admissible.



## Arrival of Goods

Imported goods are not legally entered in the U.S. commerce until after the shipment has arrived within the port of entry, Customs has authorized delivery of the merchandise and the estimated duties have been paid. This is normally accomplished by filing the entry documents, either by the importer or by the importer's agent. In addition, it is the importer of record's responsibility to arrange for examination and release of the goods.

Customs does not notify the importer of the arrival of the shipment. The carrier of the goods usually makes notification of arrival. Arrangements should be made to ensure that the importer or its agent is informed immediately of arrival so that the entry can be filed and delays in obtaining the goods avoided.

## Classification

The importer must determine the classification number of the merchandise being imported. The Harmonized Tariff Schedule of the United States (HTSUS), issued by the United States International Trade Commission, prescribes the classification of merchandise by type of product; e.g., animal and vegetable products, textile fibers and textile products. Improper tariff classifications can result in the underpayment or overpayment of duties owed to Customs or the failure to satisfy import restrictions.

## Duty Rates

The duty rate of an item is tied to its classification number so the importer must pay estimated duties and processing fees if applicable.

The HTSUS provides several rates of duty for each item: general rates for countries with which the U.S. maintains normal trade relations (NTR); special rates for special trade programs (zero, or lower than the rates currently assessed on goods originating in NTR countries); and column 2 rates for imports not eligible for either general or special rates.

Customs duties are generally assessed at ad valorem rates, a percentage of which is applied to the dutiable value of the imported goods. Some articles, however, are dutiable by some other form of measurement and others at a compound rate of duty (i.e., combination of both ad valorem and specific rates).

Special trade programs such as NAFTA and Generalized System of Preferences (GSP) allow for a reduced or zero duty rate for qualifying imports. Each trade program has rules of origin that should be closely examined before making such a declaration for preferential duty treatment.

## Valuation

The importer must declare the dutiable value of merchandise. The means of appraisal must be accepted by Customs. Several appraisal methods are used to arrive at this value. The transaction value serves as the primary basis of appraisal. Transaction value is the price actually paid or payable by the buyer to the seller for the goods imported. Other costs may affect the dutiable value of merchandise, such as packing costs, selling commissions, royalty or licensing fees, etc.

## Penalties

Customs laws set forth strict monetary penalties for false statements and/or omissions. Specifically, a violation of 19 U.S.C. §1592 occurs when a person, through fraud, gross negligence, or negligence, enters, introduces, or attempts to enter or introduce any merchandise into the commerce of the U.S. by means of any document or electronically transmitted data or information, written or oral statement, or act which is material and false, or any omission which is material or aids or abets any other person in such activity. A document, statement, act, or omission is material if it has the potential to alter the classification, appraisal, or admissibility of merchandise, or the liability for duty, or if it tends to conceal an unfair trade practice under the antidumping, countervailing duty or similar statute, or an unfair act involving patent or copyright infringement. Violations of 19 U.S.C. §1592 can occur regardless of whether the false act or omission deprives the U.S. of duty.

Many violations could also result in the assessment of liquidated damages against the company's importer's bond. These penalties can apply both to dutiable and duty-free items.

## Focused Assessments and the Importer Self-Assessment Program

Customs uses Focused Assessments as a means to evaluate the compliance of importers with U.S. Customs laws and regulations. Although Customs has the right to verify the data of each individual Customs Entry filed for imported merchandise, the Focused Assessment (FA) program allows Customs to review and evaluate the internal controls and procedures implemented by a company to ensure accurate data is routinely submitted to Customs.

The Importer Self-Assessment (ISA) program is a voluntary program that allows qualified importers to assume the responsibilities for assessing their Customs compliance with less Customs oversight. ISA participants may be removed from the audit pool established for comprehensive audits, including FA's. In order to participate in the ISA program, an importer must be a member of the Customs-Trade Partnership against Terrorism



(C-TPAT), must be a resident importer of the U.S., must have two years of importing experience prior to the date the importer applies to the program and comply with all applicable Customs laws and regulations among other things. The importer may meet the requirements of the ISA program by using internal resources or using an objective third party exercising due diligence and reasonable care.

## C-TPAT

C-TPAT is a joint government-business initiative aimed at building cooperative relationships that strengthen overall supply chain and border security. Although the government describes the program as voluntary, it has become necessary from a business perspective to: (1) reduce border delays and (2) meet customer requests that suppliers participate in C-TPAT. Customs requires participants of C-TPAT to adopt methods to manage the security of their supply chain. Applicants must submit signed agreements to Customs, representing their commitment to the C-TPAT security guidelines.

## Foreign Trade Zones

A Foreign-Trade Zone (FTZ) is a restricted access site in or adjacent to a Customs port of entry. Under zone procedures, foreign and domestic merchandise may be admitted into zones for operations such as storage, exhibition, manipulation, destruction, assembly, manufacture and processing, without being subject to formal Customs entry procedures and payment of duties, unless and until the foreign merchandise enters the Customs territory for domestic consumption.

## Federal Income Tax

### Overview

Consistent with its overall system of government, the United States tax system is comprised of separate Federal, state and local taxes. Federal taxes support the national government while state and local taxes support the respective political subdivisions. This addresses the U.S. Federal income tax system.

In addition to income taxes, the U.S. Federal tax system contains specific excise, estate, and gift taxes. The U.S. Federal tax system does not include a national sales tax or a Federal value added tax.

The U.S. Congress enacts Federal income tax legislation. U.S. Federal income tax legislation generally is codified in the Internal Revenue Code (“IRC”) of 1986 (Title 26 of the United States Code), as amended. The bilateral income tax treaties to which the United States is a party and other Congressional enactments are additional sources of Federal income tax law.

The Internal Revenue Service (“IRS”), a bureau of the U.S. Treasury, enforces the Federal income tax provisions contained in these various sources.

The U.S. Federal income tax system is an extremely complex set of laws that are subject to constant change. These changes arise, in part, to assist the U.S. Congress in achieving specific revenue raising goals.

In addition to raising revenue, the U.S. Congress uses certain income tax provisions as a means of encouraging and discouraging certain forms of economic conduct by either offering tax incentives or disincentives in comparison to alternate economic choices. These laws are often supplemented with regulations, rulings, and other administrative pronouncements issued by the IRS.

The U.S. Federal income tax system is premised upon taxpayers voluntarily filing required annual tax returns on a timely basis and remitting taxes owed. Taxpayers generally have an obligation to pay estimated taxes due for the entire year on a periodic basis throughout the year via source-based withholding from certain types of income. At the end of the tax year (usually a calendar year), the taxpayer files an annual return for the tax year and determines his annual tax liability for that year. If previously withheld taxes exceed the total tax due, a refund of tax is made. If additional taxes are owed, payment of the outstanding amount is required.

## U.S. Corporate Income Tax

There are two broad types of corporations in the U.S.:

- (1) Corporations that are subject to tax at the corporate level
- (2) Corporations that are treated as pass-through entities whereby the corporate income is instead taxed at the shareholder level.

Traditional corporations (subchapter C corporations) are taxed at the corporate level and their income is generally taxed again upon receipt by shareholders; i.e., subject to double tax. Corporations treated as pass-through entities can avoid this double taxation. There are a wide variety of non-tax considerations associated with the choice of corporate structure. In addition, some entities can not achieve pass-through tax status if a foreign person is a shareholder. A U.S. corporation is required to file an annual Federal income tax return even if it has no income or tax due. Form 1120 is generally used although a short form (Form 1120-A) can be used if gross receipts are less than \$500,000 and certain other requirements are met. A foreign corporation engaged in a U.S. trade or business at any

time during the taxable year must file a Federal income tax return (Form 1120-F). The U.S. has a largely progressive rate structure, i.e., marginal income tax rates increase with the amount of income. For corporations subject to the Federal corporate income tax, the following tax brackets are in place for the 2008 tax year:

TAXABLE INCOME	INCOME TAX LIABILITY
\$0 to \$50,000	15% on the amount over \$0
\$50,000 to \$75,000	\$7,500 + 25% on the amount over \$50,000
\$75,000 to \$100,000	\$13,750 + 34% on the amount over \$75,000
\$100,000 to \$335,000	\$22,250 + 39% on the amount over \$100,000
\$335,000 to \$10,000,000	\$113,900 + 34% on the amount over \$335,000
\$10,000,000 to \$15,000,000	\$3,400,000 + 35% on the amount over \$10,000,000
\$15,000,000 to \$18,333,333	\$5,150,000 + 38% on the amount over \$15,000,000
over \$18,333,333	35% on the amount over \$0

Various business deductions and tax credits may be available in computing a corporation's taxable income. Deductions available to corporations include ordinary and necessary business expenses, the net operating loss deduction and the dividends received deduction, as well as the option to amortize certain organizational expenses. Domestic corporate rates apply to income of a foreign corporation effectively connected with a U.S. trade or business. U.S. source income of a foreign corporation that is not effectively connected with a U.S. trade or business is taxed at a flat rate of 30% of the gross amount without deductions, however this tax rate be reduced by an applicable bi-lateral tax treaty to which the U.S. is a party.

### The General Business Credit

The general business credit is a limited nonrefundable credit comprised of various business-related credits found in IRC §§ 40 through 45P. The general business credit for a tax year is the sum of:

- (1) The business credit carryforwards for the year
- (2) The amount of the current year business credit
- (3) The business credit carrybacks to that year

The general business credit may not exceed the limitation contained in IRC§ 38(c), although the amount of the credit used in a particular tax year may be carried back one year and carried forward twenty years.

### Income Tax on U.S. Branches of a Foreign Corporation

In response to concerns about the parity of the amount of taxes paid by U.S. corporations and foreign corporations doing

business in the United States with respect to similar operations, the U.S. Congress enacted a branch profits tax in 1986. Pursuant to IRC § 884, a tax on the branch profits of a foreign corporation is imposed through three separate ways. In the first context, the profits of a foreign corporation's U.S. business operations that are considered to have been repatriated to the parent country are taxed.

In the second context, interest deemed to have been paid by the U.S. branch of a foreign corporation to foreign lenders is subject to the branch withholding tax.

Finally, "excess interest" that is apportionable to the effectively connected income of a foreign corporation is deemed paid by the branch to its parent and is subject to the branch-level interest tax.

Applicable income tax treaties may also modify various facets of this complicated branch tax.

### Individual Taxation

U.S. citizens and resident aliens are taxed on their worldwide income. The individual income tax rates are graduated and different exemptions and standard deductions apply depending upon the taxpayer's filing status. The following rates apply for tax year 2008 for taxpayers that are married and filing jointly:

TAXABLE INCOME	INCOME TAX LIABILITY
\$0 to \$14,600	10% on the amount over \$0
\$14,600 to \$59,400	\$1,460 + 15% on the amount over \$14,600
\$59,400 to \$119,950	\$8,180 + 25% on the amount over \$59,400
\$119,950 to \$182,800	\$23,317.50 + 28% on the amount over \$119,950
\$182,800 to \$326,450	\$40,915.50 + 33% on the amount over \$182,800
over \$326,450	\$88,320 + 35% on the amount over \$326,450

A personal exemption in the amount of \$3,500 for tax year 2008 generally is deducted from a taxpayer's gross income, as well as an exemption in the amount of \$3,500 for each of the taxpayer's dependents. Various deductions and tax credits may also be available, decreasing an individual's taxable income.

U.S. citizens and resident aliens are required to file an annual Federal income tax return Form 1040 if their gross income levels exceed specified thresholds (between approximately \$8,000 and \$16,000 depending upon their filing status) even if no tax is owed.

All such returns must include a taxpayer identifying number (TIN). The TIN is the individual's social security number. If the individual does not have a social security number, he can obtain one by filing a Form SS-5.

A non-resident alien must file a Federal income tax return (Form 1040 NR) for any year in which either:

- (1) The alien is engaged in a U.S. trade or business
- (2) Any tax is owed for the year, i.e., not satisfied through withholding
- (3) The alien's tax status for the year is a resident alien under the IRC but a non-resident alien under the tie-breaker rules of an income tax treaty.

U.S. residency for Federal income tax purposes can arise if the individual is a lawful permanent resident for immigration purposes, i.e., possesses a "green card," or meets certain physical presence tests based upon the number of days in the United States during the last three calendar years.

In addition to Federal income tax returns, there may be an obligation to file Federal employment tax and excise tax returns. An employer subject to either income tax withholding or social security taxes, or both, must file a quarterly return. Form 941 combines the reporting of income and FICA taxes withheld from wages, tips, etc.

## Taxation of Pass-Through Entities

Certain business entities (e.g., partnerships, S corporations, limited liability companies and entities validly electing to be treated as pass-through entities pursuant to the "check the box" regulations) do not pay taxes at the entity level. Instead, income earned by the entity and attendant tax items flows through to the individuals and/or entities owning the entity and is reported by them as income, in the manner specified by the agreement amongst the individuals owning the entity and as may be governed by applicable Federal and state law.

With the advent of limited liability companies and similar corporate entities, the use of traditional partnerships is gradually waning. Generally, small and medium-sized businesses are formed as limited liability companies, which are taxed as pass-through entities under the "check the box" regulations. The limited liability company form is very flexible and items of income, deductions and tax credits are allocated among the members according to the operating agreement.

Partnerships and limited liability companies file an annual information return, Form 1065. Each partner or member's income and attendant tax items from the partnership or limited liability company is reported on Schedule K-1 of Form 1065, with Schedule K-1 sent to each partner or member.

## Taxation of Trusts and Estates

An estate or trust is a separate taxable entity. An estate or trust computes its tax liability at rates similar to those for individuals. The entire income of an estate or trust generally must be reported on Form 1041, which is prepared by the fiduciary of the estate or trust.

If income is required to be distributed or is properly distributed to a beneficiary, the estate or trust is viewed as conduit for such distributions which retain the same character for the distributees that it had in the estate or trust. The estate or trust is allowed a deduction for the portion of gross income properly distributable to the beneficiaries or is properly paid or credited to them. The distributee of an estate or trust must include the distribution as income.

## Filing Dates for Returns & Payments

Individual taxpayers must file Form 1040 by April 15. This deadline can be automatically extended for four months by filing Form 4868 and the IRS may grant an additional extension upon request from the taxpayer. Any tax due and owing as of April 15 accrues additional interest if an extension is sought.

Corporate taxpayers that use the calendar year for reporting income and expenses must file Form 1120 by March 15. Corporations using a tax year other than a calendar year must file Form 1120 by the 15th day of the third month after their fiscal year end. Like individual taxpayers, corporate taxpayers may request an automatic extension of six months to file the return, provided that it timely and properly files a Form 7004 and deposits the full amount of the tax due with Form 8109. The return due date may be further extended with permission from the IRS.

Partnerships and similar pass-through entities file an annual information return using Form 1065. A U.S. partnership's information return must be filed by the 15th day of the fourth month following the close of the tax year. A foreign partnership that has U.S. source income is not required to file a partnership return if the partnership has no effectively connected income and no U.S. partners at any time due the partnership's tax year. A partnership also may apply for an automatic three-month filing extension using Form 8736.

Certain taxpayers must estimate their tax liability and pay a portion of it on a quarterly basis.

Late filed returns will incur a penalty of 5% to 25%. Failure to pay a tax owed will result in a penalty of 1/2 of 1% per month. Substantial underpayment of tax owed will result in a 20% penalty of the tax that should have been remitted.

## Depreciation and Depletion

A deduction is allowed for the exhaustion, wear and tear (“depreciation”) of property used either in a trade or business or property held for the production of income. The amount deductible for tangible property, including real estate, placed in service after 1986 is determined under the Modified Accelerated Cost Recovery System (“MACRS”).

Certain intangible assets may be amortized over 15 years under IRC § 197. Other intangible assets may be depreciated under another provision (IRC § 167) if the asset has an ascertainable value and a useful life that can be measured with reasonable accuracy. Depreciation deductions may be restricted for certain property that lends itself to personal use, entertainment, recreation or for amusement.

In addition, certain taxpayers may elect to deduct as an expense, rather than depreciate, up to a specified amount of the cost of certain personal property placed into service during the tax year in the taxpayer’s trade or business.

Congress recently increased the annual amount that can be expensed for the 2008 tax year to \$250,000. This expensing election begins to phase out when the amount of investment in qualified property for that year exceeds approximately \$800,000. In subsequent taxable years, the limitation on the amount of capital expenditures that can be deducted as expenses is expected to decrease to approximately \$125,000 and the phaseout amount for investment in qualified property will commence at approximately \$500,000.

A deduction is also allowed for the depletion of natural sources, based on the taxpayer’s economic interest in the property.

## Research and Development Tax Incentives

A credit for increased research expenditures is one of the credits making up the general business credit. This credit is available for amounts paid or incurred through December 31, 2009. Congress has periodically extended the period in which the credit can be claimed but did allow it to lapse for a brief period several years ago. The credit is generally computed as the sum of:

- (1) 20% of the excess of qualified research expenses for the current tax year over a base period amount
- (2) 20% of the basic research payments made to a qualified research organization.

Taxpayers may also elect to deduct certain research and experimental costs in the tax year in which these costs are paid or incurred. This deduction must be reduced by the amount of the research credit taken under the general business credit.

## Capital Gains

Gain or loss from the sale or exchange of a capital asset is characterized as either short-term capital gain (or loss) or long-term capital gain (or loss), depending on how long the taxpayer held the asset in question.

If a taxpayer has both short-term and long-term gains during a year, each type is reported separately and gains and losses for each category are netted separately. The net long-term capital gain or loss for the taxable year is then combined with the net short-term capital loss for the year to arrive at a combined total capital gain or loss.

Following 2003 Congressional tax legislation, the maximum tax rate for non-corporate taxpayers concerning capital gains is 15%. A corporation is taxed on net capital gain at the regular tax rates. The holding period for long-term capital assets generally is 12 months.

## Consolidation of Tax Returns

A group of affiliated corporations can elect to file a single consolidated Federal income tax return. Corporations must be “includible” as well as affiliated in order to file such a consolidated return.

An affiliated group is defined as one or more chains of includible corporations connected through stock ownership with a common parent that is an includible corporation provided:

- (1) The common parent must directly own stock possessing at least 80% of the total voting power of at least one of the other includible corporations and having a value equal to at least 80% of the total value of the stock of the corporation
- (2) Stock meeting the 80% test in each includible corporation, other than the common parent, must be owned directly or indirectly by one or more of the other includible corporations. Foreign corporations are generally not includible but a limited exception exists for certain Canadian and Mexican corporations.

## Loss Carry Forward and Carry Back

Most taxpayers are permitted to carry back a net operating loss from a trade or business to apply as a deduction against prior income and to deduct from succeeding years’ income any unabsorbed loss. A net operating loss is simply the excess of allowable deductions over gross income, as computed under the law in effect for the loss year, with required adjustments. There are a number of adjustments for individuals and corporations.

Generally, net operating losses can be carried back two years preceding the loss year and then forward to the 20 years following the loss year. A five-year carryback provision applies to net operating losses that arise in taxable years 2001 and 2002. For net operating losses that arose in tax years beginning before 1997, there are additional carry back and carry forward rules. In addition, a taxpayer may elect to forego the carry back period under certain circumstances.

## Tax Deferred Corporate Reorganizations

The Federal income tax treatment of gains and losses associated with the dispositions of property is subject to an extremely complex set of statutory provisions, regulations, and judicial interpretations.

This is especially so concerning the transfers of assets from individuals and business entities to other individuals and business entities. The IRC contains a series of provisions whereby certain asset transfers are tax-free, based upon the assumption that the new property received is substantially a continuation of the old investment without liquidation. The formation of certain business entities, the amalgamation and division of business entities, and the dissolution of certain business entities often can, with careful tax planning, be effectuated in a tax-free manner.

## Tax Audits and Appeals

The IRS has broad authority to audit the tax affairs of businesses and individuals in order to insure compliance with applicable U.S. income tax laws. This includes the examination of filed returns and the identification of situations in which returns should have been filed but were not.

In order to satisfy its compliance objectives, the IRS uses sophisticated computer technology and the accumulated experience of its personnel in the classification and selection of returns and other situations for further examination. There are a variety of types of examinations that allow the IRS to dedicate appropriate resources to a specific situation with the goal of the efficient use of its limited audit resources.

Once an examination begins, the IRS is generally able to obtain any information relevant to the determination of tax liability – either from the taxpayer under examination or third parties. The exception to this expansive breadth of examination authority is limited to certain attorney-client communications, attorney work product endeavors and a narrow range of tax practitioner-client communications. Factual determinations by the IRS in examinations are presumptively correct, even if the taxpayer has not provided any information.



Although the IRS has broad examination authority, there are numerous procedures to protect the interests of taxpayers.

An individual or business under examination can challenge IRS tax determinations both within the IRS administrative structure and through the independent Federal judicial system. Within the IRS, a taxpayer may have his matter reviewed by the IRS Appeals group through an administrative proceeding.

If the taxpayer is not satisfied with the outcome or chooses to bypass this alternative, he may have his proposed tax liability reviewed by one of several potential Federal courts. Each court has different jurisdictional requirements and advantages/disadvantages. Provided that a taxpayer complies with all applicable procedures, he may always have his proposed tax liability reviewed by a Federal court before the tax is determined to be due and owing except in extremely limited circumstances necessary to protect the interests of the government.

The IRS generally may propose to assess additional taxes within three years from the date the return was filed. This period may be extended if there is a substantial omission of income or with the consent of the taxpayer. If no return was filed or if a false or fraudulent return was filed, the IRS may propose to assess additional tax at any time.

## IRS Letter Rulings

A letter ruling is a written statement from the IRS's National Office in response to a written request from a taxpayer and sets forth the way the IRS will treat a prospective or completed transaction for Federal tax purposes. IRS letter rulings are also known as private letter rulings, PLRs, advance rulings or simply rulings.

The IRS has discretion to issue rulings when it is in the interest of sound tax administration. A taxpayer's request for a letter ruling must be made in accordance with established procedures and generally must contain all relevant facts.

The IRS periodically publishes revenue procedures that set forth the procedure for obtaining letter rulings. These procedures may also identify matters in which letter rulings are not available. For certain types of matters, such as a change in accounting methods, obtaining a ruling can be mandatory in achieving the favorable tax treatment.

A ruling is honored, with specific exceptions, by all IRS officials and offices but only concerning the taxpayer to whom the ruling was issued. The IRS releases issued letter rulings but with certain identifying information blocked out to preserve the anonymity of the taxpayer.

Although other taxpayers may not formally rely upon the letter ruling even if they follow all of the particulars contained therein, other taxpayers often rely on issued rulings in their tax deliberations. The IRS generally processes letter rulings within 90 days of receiving the required information.

## Income Tax Treaties

The United States has entered into over 30 bilateral income tax treaties with various countries, including most of the industrialized nations and major trading partners. The existence of an income tax treaty is a significant event in that it enhances opportunities for trade between contracting countries. As each country possesses different substantive tax regimes, a mechanism for enhancing additional tax harmony between the two countries is instrumental in fostering free international trade and investment.

The most important functions of these treaties are:

- (1) To avoid excessive or double taxation of income
- (2) To assist in the prevention of tax avoidance and evasion.

Each bilateral treaty to which the United States is a party is negotiated separately; hence, the provisions are generally similar but not identical. These tax treaties usually contain four broad categories of provisions:

- (1) Substantive provisions which help to relieve the burden of excessive or double taxation by allocating between the countries the primary right to tax income
- (2) Provisions that ensure the application of domestic statutes in a nondiscriminatory manner

- (3) Administrative provisions
- (4) Rules defining the scope of the treaty.

Income tax treaty provisions have equal force with domestic tax law. These provisions can, inter alia, reduce withholding tax rates, raise the nexus standards for filing tax returns, and provide a mechanism for eliminating double taxation.

The mechanism for eliminating double taxation of income, found in the mutual agreement procedure article, is the sole remedy for taxpayers when two authorities seek to tax a particular item of income following a proposed cross-border tax adjustment. In the absence of an appropriate resolution of the matter, a group of affiliated companies could have the same item of income taxed by two countries.

## Sales, Use, and Other Taxes

Each of the fifty states has its own individual taxing scheme for businesses. The local cities, counties, and townships may also impose local taxes on businesses and individuals. The statutes, rules, regulations and court cases of each state and locality will determine the exact types of taxes and the corresponding tax liability of a foreign business. They should be consulted prior to an entity engaging in business in a particular state.

In addition, before a state can impose taxes on a foreign entity, the entity must have some minimum connection, or "nexus" with the state. Nexus is determined under the Due Process and Commerce Clauses of the United States Constitution, federal statutes, state constitutions and state statutes. If an entity is contemplating doing business in a state, it should consult its tax and legal advisors. Some of the more common state and local taxes imposed by most states are discussed below.

### Sales Tax

Most states impose a transaction tax, or sales at use tax, on the privilege of doing business in the state. The sales tax is generally imposed on the sale at retail of tangible personal property and some specifically enumerated services (for example telecommunications or dry cleaning). The rate of sales tax varies by state, but is generally in the range of 4% to 7%, with some states having higher tax rates. Each state also has enacted specific exemptions from sales tax. Common exemptions include sales to non-profit entities, sales for re-sale and industrial processing.

The liability to collect and remit sales tax is on the seller.

Directors and officers of an entity who fail or refuse to remit sales tax can be held personally liable for the unpaid use tax (including penalties).

## Use Tax

The use tax is a compliment to the sales tax and is imposed in most states concurrently with the sales tax. The use tax is imposed on the use, consumption or storage of tangible personal property in the state. As with the sales tax, there are exemptions available for certain transactions. Usually the use tax is levied at the same rate as the state's sales tax.

The liability to collect and remit use tax, is on the user or consumer of the property. In some instances the remote seller of the property may be liable for the collection and remittance of the use tax. Directors and officers of an entity who fail or refuse to remit use tax can be held personally liable for the unpaid tax (including penalties).

## Income/Franchise Tax

Many states also impose an entity level income tax that is often based on federal taxable income with certain modifications. Each state's modifications to federal taxable income vary widely, but some common modifications include a disallowance for state income taxes paid. If an entity is doing business in more than one state, the tax base will be apportioned in some manner, often based on the entity's property, payroll and sales. Each state's apportionment formula will vary and care should be taken to determine the exact apportionment formula a specific state employs.

Many states also impose an entity level franchise tax that is generally based on the entity's capital stock and other items of owner's equity. The tax base is then apportioned to the state using an apportionment formula. As with the income tax, the states that impose a franchise tax have individual statutes, regulations and case law that are applicable to the calculation of the state's franchise tax.

It should also be noted that some states require taxpayers to calculate both the income tax and franchise tax, but the tax liability due is only imposed on the higher of the two calculations. There may also be income/franchise taxes imposed by local governmental units that a business should also be aware of.

Some states do not impose a traditional income tax on businesses (as opposed to individuals), but do impose an entity level tax. Washington imposes its Business and Occupations tax, which is a tax imposed on an entity's gross receipts. Effective January 1, 2008, Michigan imposed the Michigan Business Tax, which has two tax bases, and taxpayers are subject to both: a business income tax imposed at a rate of 4.95% and a modified gross receipts tax imposed at a rate of 0.80%. There are a handful of states that do not impose an income tax at all, including Nevada and Alaska.

## Property Taxes

Most states or local jurisdictions also impose a tax on property located in a specific jurisdiction. The tax can be applied to real property, tangible personal property, or in some instances, intangible property. A local jurisdiction, rather than the state, often administers property taxes. The tax is generally based on the value, or a percentage of the value, of the property in the jurisdiction.

## Other Taxes

Other taxes that could be imposed by a state or locality include an intangible tax. If the entity also employs individuals in a particular state, the entity could be required to withhold and remit individual state income taxes from the individual. Employers could also be required to remit unemployment and worker's compensation taxes.

It cannot be stressed enough that each state and local jurisdiction has its own statutes, regulations and case law that govern for the jurisdiction's taxing scheme. If an entity is contemplating doing business in a particular state, the entity should consult its tax adviser to determine the exact laws and regulations the entity may be subjected to for a particular jurisdiction, as well as the compliance requirements.

## Financing the U.S. Operation

### Owner Loans and Capitalization

Financing a U.S. business operation from abroad can be made through loans to, or contributions to owner or share capital of, the U.S. company by the foreign parent.

Loan interest payments made abroad to the foreign parent will be subject to U.S. withholding tax, which may be at a more favorable rate determined by applicable income tax treaty. If loans are non-interest bearing or below market, interest paid abroad will be imputed and the same U.S. income tax issues will arise.

Additionally, if the U.S. company bears excessive foreign parent debt, the U.S. Internal Revenue Service ("IRS") may deem the U.S. company to be "thinly capitalized." If the IRS determines that the U.S. company is thinly capitalized, then foreign parent debt may be re-characterized as a contribution to owner or share capital. In such case, the repayment of principal would be a dividend to the foreign parent to the extent of undistributed earnings and profits in the U.S. company. In addition, interest payments owed by a U.S. company to its foreign parent may not be deductible, if the U.S. company's debt-to-equity ratio exceeds 1.5 to 1.

Assuming adequate capitalization of the company as per above, (a) repayments of principal can be made abroad without U.S. withholding tax and (b) interest payments can be deducted by the U.S. company, provided that the loan is documented by a promissory note, bears a reasonable rate of interest, and payments of principal and interest are made on a timely basis pursuant to the terms of the promissory note. For loans not evidenced by such formalities, repayments of principal may be classified as a taxable dividend subject to U.S. withholding tax.

If financing is carried out by contributions to owner or share capital, any attempted repatriation of owner equity will be classified first as a dividend to the extent of undistributed earnings and profits in the U.S. company. Any dividend payment made abroad will be subject to U.S. withholding tax, which may be at a more favorable rate determined by applicable income tax treaty. Thereafter, repatriations of owner equity which are not classified as a dividend payment can be made abroad without U.S. withholding tax to the extent of owner or share capital originally contributed to the U.S. company.

In the event of a liquidation of company assets, owner debt will be paid out before any return of owner equity, subject, however, to the claims of other creditors, secured and unsecured. This situation can be further improved by securing owner loans through a security agreement or a mortgage, covering some or all assets of the U.S. company. Registration of a public notice of such security interests must be made in appropriate land registry or personal property security offices in order to perfect the secured interest and obtain priority over unsecured or most subsequent secured creditors.

Often, when a U.S. company's activities increase to a level that bank financing is required, all owner loans and security for such loans must be subordinated to bank loans. However, even if such subordination is given, secured owner loans may still have priority over loans of most other company creditors.

## **Government Incentives**

Federal, state, and local governments of the U.S. encourage company location, development, and expansion through the grant of governmental incentives, which include, among other things: (a) real estate, personal property, and income tax abatements/credits, (b) company loans (which may include market or below market interest rates), and (c) outright financial grants.

Activities or commitments for which governmental incentives will be granted include: (a) location of manufacturing or assembly plants, (b) employment of threshold levels of low-

skilled, semiskilled, or high-skilled employees, (c) retraining and skill development of local workforce, (d) engaging in strategically targeted industries, high technology activities and/or location of research and development centers, and (e) location in, and rehabilitation of, contaminated or blighted urban sites.

A company seeking governmental incentives must do so through the federal, state, or locally sanctioned economic development agencies or municipal corporations. Preparation, submission, and negotiation of written proposals, applications, and commitments with these economic development organizations is necessary and often must precede entering into binding commitments to purchase or lease facilities or equipment. Preparation of cross-state comparisons or comparisons between localities may induce further governmental incentives from the state or local government. Using personal contacts within these economic development organizations can, at times, prove to be a decisive factor in securing incentives. In order to assess the constantly changing availability of government incentives for companies, it is best to obtain professional assistance.

## **External Debt Financing - U.S. and State Chartered Banks**

The U.S. commercial banking system is characterized by many national and regional U.S. and/or State chartered banks. Selecting a large "money-center" bank (e.g., New York) or a regional bank may depend on the particular needs or service expected from the bank. For example, some regional banks may specialize in providing banking services to a particular industry (e.g., automotive industry). A large "money-center" bank likely has a strong presence internationally and foreign offices that can provide a useful local liaison for the foreign investor contemplating the establishment of a U.S. company.

### ***Revolving (Operating) Lines of Credit***

Banks typically provide two distinct kinds of loans for a new company. The first is the revolving (operating) line of credit, whereby the company is granted a revolving line of credit to finance its working capital. Under a revolving line of credit, money is borrowed, repaid, and then may be re-borrowed. Banks grant revolving lines of credit on either a demand or committed basis. Under a demand revolving line of credit, the bank may, at its option, demand immediate repayment of the outstanding balance for whatever reason and regardless of whether the borrower is in default. Under a committed revolving line of credit, the bank may typically only demand repayment upon maturity or if the borrower is in default. Draws under this kind of facility are made through borrower advances or issuance of letters of credit.



Interest rate options currently offered by banks for revolving lines of credit consist primarily of either a floating prime-based rate or a rate based on the London Interbank Offer Rate (“Libor”). Loans are denominated in U.S. dollars only; however, some banks may provide currency hedging products to insulate companies from foreign currency rate fluctuations.

Revolving lines of credit are structured on a formula basis, which makes available credit dependant upon the continuing value of certain qualifying assets in which the bank has a security interest, mortgage, or other lien. Typical assets secured include accounts receivable, inventory, equipment and real property. Thus, it is very common for the effective amount of available credit to the company to be less than the stated amount of the revolving line of credit and limited to a percentage of the value of the inventory and receivables of the company after allowing for aged receivables, bad debts, obsolete inventory, etc. This may be in sharp contrast to some foreign countries where the amount of available credit may not be subject to fluctuations in asset values occurring after issuance of the revolving line of credit.

Practically speaking however, banks request as much security as possible and may often require security on all of the other assets of the borrower as well as seeking guarantees from owners. Therefore, owner loans and related security interests are typically subordinated and assigned to the bank. The banks usually require that it be listed as a named insured on any insurance policy covering the assets of the company. In particular, for smaller borrowers, banks may also require that death benefits on key-man life insurance policies be assigned to the bank in advance.

#### ***Term Loan Facilities***

Banks also typically make term loans for a fixed period of time. Term loans usually finance the acquisition of specific assets of the company or provide additional long-term working capital to the company based on the current value of existing capital assets (such as equipment). The main difference between a term loan and an operating loan is that, while under a revolving line of credit whereby money is borrowed, repaid, and then re-borrowed, a term loan is drawn upon once, in-full, and repaid over its term pursuant to an agreed schedule.

The principal security taken for a term loan is usually in the form of a lien on specific assets. However, banks are likely to require security over all of the borrower’s assets, especially if the bank is also providing a revolving line of credit. Additional methods of security described above and loan guarantees apply equally to term loans as well. In certain circumstances, the bank may also require the additional support of a stand-by letter of credit. In addition to interest rate options such as a floating

prime-based rate or Libor-based rate, banks offer fixed rates of interest for term loans as well. Fixed rate term loans may be subject to a prepayment penalty if the borrower prepays the loan or if repayment is accelerated by the bank in the event of a borrower default.

#### **External Debt Financing - Foreign Banks**

In addition to domestic banks, many foreign bank subsidiaries are currently operating in the U.S. The foreign bank subsidiaries concentrate almost exclusively on commercial banking activities. Foreign bank subsidiaries often provide the necessary financial liaison with the foreign investor and the parent bank in their home country when a new U.S. company is established.

#### **Other Financing Sources**

In addition to U.S. or foreign banks, senior debt financing may also be available from non-bank financial institutions. Also, in certain circumstances, financing for capital asset acquisitions can be secured from the manufacturer or a third party lease financing company through an operating lease or financing lease. Lease financing companies assist companies with acquiring capital assets by buying the desired assets and then leasing the assets to the company under an operating or financing lease. Operating leases are short in duration and the capital asset is returned to the lessor upon expiration of the lease term. Financing leases have a longer duration, covering the predominant useful life of the asset, and usually have a bargain purchase option upon termination of the lease. Such methods of financing capital asset acquisitions may reduce or eliminate the need for a substantial initial payment and allow the company to pay for use of the assets over time from company cash flow. In some situations, a company may also seek the services of a factoring company to improve its cash flow. A factor may purchase or lend against the company’s accounts receivable at a discount and will endeavor to collect the receivables, with or without recourse to the company, depending on the particular agreement. An additional source of financing may be secured from so-called “mezzanine lenders.” These lenders provide loans on a basis subordinate to the senior lenders, but prior to any seller or owner debt, often together with a warrant for stock or other interest in the company. Mezzanine financing is more expensive than interest rates charged on senior debt, but may be key to financing a leveraged acquisition.

#### **External Equity Financing - Venture Capital**

There are many companies in the U.S. willing to provide venture capital to new companies, sometimes together with senior or subordinate loans. Typically, these venture capital companies are interested in acquiring a high rate of return and will take a substantial minority equity position in the company.

For their investment, venture capitalists will want significant control over the management and direction of the company. This control factor must be considered carefully before seeking venture capital financing.

## Private Placements and Public Offerings

Raising funds from the public, whether through private placement of investment securities to a few sophisticated investors or through public offering of investment securities to the general public, is usually effected through brokers and investment bankers. Depending on the size and sophistication of the company, the issuance of investment securities in the U.S. may provide a source of financing that may not be readily available in the foreign country. The issuance of investment securities is subject to the U.S. Securities Act of 1933, which imposes requirements covering registration, trading and distribution of such securities.

## Economic Development Incentives

Within the United States, governmental bodies have a long history of providing businesses with incentives to locate or to expand their operations within their jurisdictional borders. Federal, state and local governments provide a variety of economic development incentives primarily focused on job creation and capital investment. Increasingly, a broad array of incentives are being offered in the energy and sustainability areas given recent public policy evolution focuses on these issues.

Although they may not be the primary reason a business decides to expand in or relocate to a particular location, they can often be a significant influence with all other factors being equal amongst locales competing for a particular project. The availability of an educated workforce, access to transportation and distribution networks, and other business considerations often are the primary factors driving a project with incentives being an important variable. Competition is often robust among states and locales for in-bound corporate economic development opportunities. Because state and local governments offer property tax incentives in many different forms, it can be difficult to determine which local government is offering the best deal. One must first understand the various forms in which the incentives are offered.

Most states offer some sort of income tax credit incentive program. The size of the package often depends upon a variety of factors, including when and how many jobs will be created, whether the company's industry is one the governmental authorities are actively trying to promote, and how difficult it has been for the relevant state or locale to attract business in general.

The vast majority of state-sponsored income tax credit programs do not provide guaranteed benefits. Income tax credit programs can contain limitations preventing otherwise qualifying businesses from utilizing earned credits. The most frequently occurring restrictions limit the use of tax credits to offset income tax liabilities generated at the new location.

Some of the income tax credit programs are "use it or lose it." This implies that if a business cannot utilize all or part of the income tax credits for the appropriate tax year, it loses the benefit. However, most income tax credit programs mitigate this detriment by providing a carry-forward period to permit the business to utilize unused credits in future years, but very few income tax credit programs guarantee such utilization by refunding unused credits or permitting the businesses to sell unused credits to other taxpayers.

If the new business owes little or no income tax during the credit program's award year or any available carry-forward period, the business stands to lose some or all of the economic benefit that the state has promised.

Another tool in the arsenal of states and locales is local real and personal property tax abatements or other property tax relief. States especially do not always go to great efforts to publicize local real and personal property tax abatements, exemptions, or other property tax relief. Those programs are generally administered at the local level and states do not want to be perceived as favoring one local government over another.

Property tax abatements are often more attractive than income tax credit incentives. Once a business has been granted real and personal property tax incentives, almost all incentives will directly offset property tax expenses that the business would otherwise have to pay, regardless of whether the business ever makes a taxable profit. Thus, if a business receives a property tax abatement or other reduction in its property tax liability, the business will actually receive the benefits that the government has promised regardless of the profitability of its business.

To illustrate this point, a business comparing locations would need to calculate each potential site's property tax, net of the incentives offered. For instance, assume that two cities are competing for an industrial expansion. The first city offers the new business a 50% property tax abatement for 20 years. The second city counters with no property tax incentives whatsoever. The choice may not be as obvious as it seems at first blush. Although a 50% tax abatement for 20 years seems quite favorable, it might not be a good deal if the second city's overall property tax rate is less than 50% of the first city's tax rate, net of the first city's incentives. The added benefit here is that the

new business will not need to go through the tax abatement/exemption application process to receive the lowest property tax expense in the second city; administrative costs would be saved as well as time and perhaps political goodwill.

States and localities in the U.S. often create incentive packages for companies creating jobs within their borders. Foreign companies frequently discuss such matters with economic development officials from several states and localities simultaneously in order to foster competition and to determine which location makes most sense for their particular needs. Governmental incentives vary from state to state, but the most common forms are as follows:

### ***Job Creation and Training Incentives***

State and local governments are sometimes willing to provide job training grants for both the creation of jobs or for workforce skills upgrade. The funds from such grants are often channeled through community colleges, intermediate school districts, licensed proprietary schools and trade academies.

### ***Geographic Development Zones***

States have increasingly been creating special geographic incentive zones designed to lure companies for specific reasons. These zones are not limited to urban areas. A common geographical incentive zone, for instance, is a tax haven zone.

Tax haven zones are designated as virtually tax free for any business or resident presently in, or moving into, such a zone. They are designed to provide selected communities with the most powerful market-based incentive—no taxes—to spur new jobs and investment. The taxes that companies and residents are exempt from paying sometimes comprise nearly all the state and local taxes levied on business activity: state personal income tax, state education tax, local personal property tax, local real property tax, local income tax and utilities tax. The duration of such zones reach as long as 20 years. In most if not all tax haven zones, the tax relief is designed to eventually be phased out. Other designated incentive areas focus on revitalizing urban communities. Urban revitalization funds have been established to provide assistance in land assembly, site preparation and infrastructure improvements. Projects in urban revitalization zones include assembly of urban industrial parks, acquisition and demolition of riverfront parcels for new office development and demolition of blighted areas to make way for new mixed-use development.

### ***Environmentally-Based Incentives***

Government officials on the local and state levels offer significant assistance incentives for the rehabilitation of contaminated properties often referred to as “Brownfields.”

These incentives are designed to encourage and assist developers who want to return contaminated property to productive use more quickly and at a lower cost than before, while still protecting human health and natural resources. Qualifying owners and operators of contaminated sites can receive significant funding to help pay for cleanup actions (as long as these owners and operators were not the cause of such contamination). Cleanup standards are often flexible in order to give developers the option of proposing creative solutions to historical contamination based on future use of the property. Finally, not only is funding often made available, but governmental authorities also frequently provide qualifying owners and operators with tax credits for the reduction of local and state tax liabilities.

### ***Research and Development***

Incentives are available in various states and locales for a wide range of activities associated with research and development (“R&D”). Most incentives focus either on companies committing a certain amount of their budget to R&D, on those that specialize in cutting edge high-technology research, or on those ready to commit significant sums of money to various environmentally friendly projects increasingly focused on sustainability and climate change related policy initiatives.

For instance, an employer in the electronics, communications, medical science and other high technology fields who also devotes a significant percentage of operating expenses to research and development may be eligible for high-technology job creation state tax credits. Such credits, depending on the state, may be awarded for up to 20 years and for up to 100% of the tax related to the project. These tax credits are designed to attract new, innovative and cutting-edge companies that specialize in new technologies. They are most often available to firms doing advanced computing, biotechnology, electronic device technology, engineering and laboratory testing related to product development, medical device technology, product research and development, advanced vehicle technology or technology that assists in the assessment or prevention of threats or damage to human health or the environment.

### ***Capital, Machinery and Land Purchases***

Investment tax credits are often present in incentive packages for companies. These credits are primarily designed to encourage and offset preliminary investment costs associated with capital purchases and the acquisition of both machinery and real property.

In summary, businesses should consider the available incentives when making a decision where to locate or to expand operations and take into account the vast array of circumstances that may

make one location more attractive than another. Tax and other financial incentives may not be among the primary reasons a business decides to expand in or relocate to a particular location but they are often very important considerations in making the final decision.

## Product Liability

### Overview

Product liability litigation is a concern for every prudent product manufacturer or supplier. The possibility of product liability litigation must be considered throughout the product planning, development, manufacturing, sales and marketing processes. While various aspects of product liability may appear daunting, the exposure presented can often be minimized and controlled through proactive attention to product liability issues both before and after a lawsuit is filed.

As with all risks, there are no guarantees, and no amount of care will eliminate the possibility of a product user being injured and bringing a suit for damages against the manufacturer or seller of the product. Effective risk management and insurance planning however, can mitigate the risks..

An awareness of the types of issues that may arise in product liability litigation is also essential. As the laws of the various states differ significantly, a product manufacturer or supplier must examine the state-specific laws applicable to any litigation that is initiated. The following outline of certain tenets of product liability law and practice in the United States is offered as a general guide to understanding the types of issues that a product manufacturer or supplier may expect in product liability litigation.

### Liability Issues

To receive judgment for damages at trial, a product liability plaintiff must generally persuade the fact finder (usually a jury) by a preponderance of the evidence (i.e., that it is more likely than not) that a defect existed in the subject product which was a proximate cause of an injury to the plaintiff. The following addresses the existence of a product defect and the types of damages to which a prevailing plaintiff is entitled.

### Types of Defects

At the heart of any product liability action is an allegation that a product is defective in some respect, generally in one or more of the following ways: (1) design defects; (2) manufacturing defects; and (3) “marketing” defects (inadequate warnings and instructions).

### *Design Defects*

A design defect allegation focuses on the actual design and specifications of all products of a particular type. The allegation inherently assumes that a product was properly manufactured, but asserts that the design specifications cause the product to be unreasonably dangerous for its intended uses. For example, a plaintiff may allege that a vehicle door is improperly designed because the chosen door latch is too weak for the size and weight of the door on which it is used, or that a motorcycle is defective in design because the exhaust pipe is routed too close to the driver’s foot rest.

### *Manufacturing Defects*

A manufacturing defect allegation asserts that a product has malfunctioned due to the manner in which it was manufactured or assembled. The implicit assumption is that the design of the product is acceptable, but that mistakes in the manufacturing process created a product that does not function as designed. For example, a plaintiff may allege that a tire blew out in service because it was improperly cured, or that a motor vehicle frame was improperly welded and failed to provide intended structural rigidity in a vehicle collision.

### *“Marketing” Defects*

Product liability law recognizes that there are obvious dangers inherent in the use of a product, and does not require consumer warnings about the existence of obvious dangers for simple tools (e.g., that sharp knives can cut flesh). However, the manufacturer or seller of a product has the responsibility of warning the user of non-obvious dangers inherent in both the proper use and the foreseeable misuses of a product. For example, fast food chains warn of the dangers of hot coffee, automobile manufacturers now warn about the dangers which airbags present to children who are front seat passengers, and tire manufacturers mold into the tire wall a warning about the dangers of mounting a 16 inch tire on a 16-1/2 inch rim.



### ***Liability Theories***

Whatever the alleged defect, product litigation generally is based upon one or more of four legal theories of liability - negligence, strict liability, breach of implied warranty, and/or breach of express warranty/misrepresentation. The availability of the theories varies between jurisdictions, but nearly every state has one or more liability theories which recognize the three types of defects discussed above.

### ***Negligence***

Negligence is the failure to use reasonable care. The focus of a negligence analysis is on the conduct of the manufacturer and the reasonableness of its decisions at the time of design and manufacture.

### ***Strict Liability***

Courts today also recognize that manufacturers and/or sellers are “strictly liable” for personal injuries caused by defective products that are unreasonably dangerous. The rationale behind this theory is that the price of a product should include the cost of compensating those who are injured when the products have defects. The focus in strict liability tends to be on the nature of the product and not on the conduct of the manufacturer or seller.

### ***Breach of Implied Warranty (Uniform Commercial Code liability)***

Article Two of the Uniform Commercial Code (the “UCC”) provides two warranties which are implied in every sale of goods: (a) The Implied Warranty of Merchantability, which provides that the goods must be of average acceptable quality and generally fit for the ordinary purpose for which goods of that type are used; and (b) The Implied Warranty of Fitness for a Particular Purpose, which provides that if a seller knows or has reason to know the particular purpose for which the goods are required and also knows that the buyer is relying on the seller's skill and judgment in selecting the goods, the goods sold must be suitable for that particular purpose. If the product fails to live up to either of the above standards, the warranty is breached.

### ***Breach of Express Warranty/Misrepresentation***

A manufacturer or seller also may incur liability when a product does not live up to express warranties or affirmative representations which it has made with respect to a product.

### ***Express Warranty***

Any affirmation of fact or promise concerning goods that becomes part of the basis of the bargain creates an express warranty. Generally, any consumer, user, or bystander can sue. If a buyer sues, the warranty must have been “part of the basis of the bargain.” If plaintiff is not in privity (e.g., bystander), he or she need not have relied on the representation as long as someone did.

### ***Misrepresentation of Fact***

A seller will be liable for misrepresentations of facts concerning a product where: (i) the statement was of a material fact concerning quality or uses of goods (mere puffery insufficient), and (ii) the seller intended to induce reliance by the buyer in a particular transaction. Liability usually is based on strict liability but may also arise for intentional or negligent misrepresentations. Justifiable reliance is required (i.e., the representation was a substantial factor in inducing the purchase). Reliance need not be the victim's (it may be a prior purchaser's). Privity between the plaintiff and the defendant is not necessary.

## **Application of Liability Theories to Different Product “Defects”**

### **Design Defects**

#### ***The Negligence Standard***

It is generally accepted that a manufacturer must exercise ordinary care in planning and designing its products so that they are reasonably safe in normal use. In the realm of negligence law, the focus tends to be upon the activities of the manufacturer and whether it acted reasonably in designing the product. At issue is whether the manufacturer undertook reasonable precautions to ensure that the plans, specifications, and materials utilized were appropriate and that the product would be reasonably safe for its normal use.

#### ***The Strict Liability Standard***

Unlike the inquiry with respect to negligence, the design defect issue with respect to strict liability is focussed upon the product itself – did the product have a defect in its design that rendered it unreasonably dangerous? Manufacturers or sellers<sup>1</sup> may be strictly liable when the product has a design defect that causes injury to another.

1 - The Restatement (Second) of Torts §402A do not directly address the applicability of the rule to sellers of used products. Courts in different jurisdictions have applied the theory based on case-specific interpretations of the policy considerations behind strict liability.

## The Tests

Courts generally recognize various tests for determining whether a product has a design defect that renders it unreasonably dangerous. Courts in different states apply these standards differently. Some rely upon one of the standards, while others apply a hybrid<sup>2</sup> of the standards, to varying degrees:

### *The “Risk-Utility Test”*

Courts applying the “risk-utility test,” sometimes referred to as the “prudent manufacturer test” to hold manufacturers, sellers or other middlemen liable, generally look to a combination of factors that focus upon the following:

- The usefulness and desirability of the product
- The safety aspects of the product – the likelihood that it will cause injury, and probable seriousness of the injury
- The availability of a substitute product or alternative design which would meet the same need, be safe, and is feasible to implement from a manufacturing and cost perspective
- The manufacturer’s ability to eliminate the unsafe character of the product without impairing its usefulness or making it too expensive to maintain its utility
- The user’s ability to avoid danger by the exercise of reasonable care in the use of the product
- The user’s anticipated awareness of the dangers inherent in the product and their avoidability, because of general public knowledge of the obvious danger of the product, or of the existence of suitable warnings or instructions.

This test eliminates the need to prove that the manufacturer or seller knew or should have known of the risk of injury by assuming that the defendant had knowledge of the particular risk encountered by the injured party. Ordinarily, it will be up to the jury to weigh all of the factors against the proofs offered by the parties, and then to render a decision as to whether the product had a design defect.

### *The “Consumer Expectations Test”*

The “consumer expectations test” was derived from the following two comments in the Restatement (Second) of Torts<sup>3</sup>:

#### **Defective Condition**

The rule stated in this Section applies where the product is in a condition not contemplated by the ultimate consumer, which will be unreasonably dangerous to him.

2 - For purposes of this booklet, we will discuss the two primary tests.

3 - The consumer expectations test has been applied to a variety of product liability actions, including manufacturing and design defects, breach of warranty and pure design defect cases. For purposes of this booklet, the consumer expectations test will be discussed in the context of design defect cases only.

### *Unreasonably Dangerous*

The article sold must be dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases it, with the ordinary knowledge common to the community as to its characteristics.

As applied, however, several ambiguities have developed in applying the “consumer expectations” test. For example, courts and legal scholars disagree as to whether the test is objective or subjective. In other words, it is not clear whether the test is what a reasonable person generally would expect as to the dangerousness of the product (the objective test), or what the particular user expected (the subjective test).

However, use of either the objective or subjective rule necessarily will implicate the marketing utilized by the manufacturer for the product. Thus, what a manufacturer states to the public regarding the safety of its product may influence whether the jury finds the product defective.

## Manufacturing Defects

### *The Negligence Standard*

Manufacturers must use reasonable care to avoid flaws in the manufacturing process that result in a product that does not meet the manufacturer's own specifications. This includes taking the necessary precautions through inspection, testing, and utilization of proper manufacturing procedures to prevent flawed products from reaching the market.

### *The Strict Liability Standard*

Strict liability applies in the manufacturing defect context when a product is defectively made, and the defect renders it dangerous to an extent beyond that which would be expected by the ordinary consumer who purchases it. In such a situation, the injured party generally will not need to show that the manufacturer or seller did anything wrong. Rather, the necessary proof, in addition to the customer's lack of expectation of danger, will be that the product failed to meet the specifications set by the manufacturer.

### *Marketing Defects – Warnings and Instructions*

An otherwise properly made product will be considered defective if it is unreasonably dangerous to place the product in the hands of a user without proper warnings and instructions. The duty to warn test is simple: if it is reasonably foreseeable that an otherwise non-defective product, when properly used or misused in a foreseeable manner, poses an unreasonable danger, the user must be warned. In addition, if the product reasonably requires instructions for use, adequate instructions must be provided. In many jurisdictions there is a presumption that the user would have heeded the warning if one had been provided.

## Content of Warnings

Warnings and instructions should be reviewed to ensure that they are appropriate in light of the risk of potential injury and the severity of potential injuries. As a basic guideline, proper warnings should include the following information in an understandable format:

- The nature of the hazard
- The nature of the user (consumer, tradesman, etc.)
- The severity of the hazard (the level of risk)
- What should be done to avoid the hazard.

## Types of Warnings

### *Operating Instructions*

It is important for a product manufacturer to include comprehensive operating instructions along with the product. This is best accomplished through an owner's manual and through an operator's training program.

#### **a. Owner's Manual**

A comprehensive owner's manual, highlighting all potential hazards and indicating what cautions should be followed by the consumer to ensure safe handling and use of the product, should be included along with the product.

#### **b. Training**

A manufacturer might also consider offering a training course to purchasers of the product to highlight safe use and operating techniques.

### *Cautions/Labels*

After deciding that some warning is necessary to the safe operation of its product, a manufacturer must answer two more questions: "What do we say?" and "How do we say it?"

The answer to the first question is derived from information received from several sources, including, for example, the manufacturer's own tests, experience and expectations, the chain of distribution, end users, and governmental agencies. As for the second question, guidance can be sought from the American National Standards Institute ("ANSI"), which promulgates standards that manufacturers can use to design and formulate warnings. See ANSI Standard Z535.

### *Doctrines which Reduce the Obligation to Warn*

Finally, the law of some jurisdictions recognizes that certain situations, usually commercial in nature, relieve the supplier of a dangerous product from otherwise stringent warning requirements when the purchaser has or should have the expertise necessary to safely handle the product. These doctrines, known by names such as "sophisticated user," "bulk

supplier," and "learned intermediary" doctrines, are useful but are not uniformly recognized in all jurisdictions and should be regarded with some caution when determining product labeling and warning.

## Damages

For a plaintiff who establishes liability, damages may be actual and compensatory (directly related to the amount of the loss) or they may be, in some situations in certain jurisdictions, exemplary and punitive. Punitive or exemplary damages provide extra money to the plaintiff to punish the defendant and to deter similar bad conduct by others.

### *Economic Damages*

A plaintiff can recover damages for his or her out-of-pocket expenses resulting from a defective product, including, but not limited to, past and future lost wages, past and future medical expenses, and property damages. A few states allow expenses paid by insurance to be excluded from economic damages.

### *Pain and Suffering/Loss of Consortium*

A plaintiff can also recover damages for pain and suffering, and the loss of companionship/consortium (love of spouse) resulting from injuries received from a defective product. The value of these types of damages is subjective and varies dramatically depending on the severity of the injury. "Tort reform" legislation in some states has created caps on noneconomic damages in certain situations.

### *Punitive Damages*

The purpose of punitive damages is to punish a defendant and to deter a defendant and others from committing similar acts in the future. In jurisdictions which allow punitive damages, the plaintiff has the burden of proving, usually in a bifurcated proceeding and by clear and convincing evidence, that punitive damages should be awarded. Punitive damages may be awarded only if the defendant's conduct was malicious, or in reckless disregard of the plaintiff's rights. Conduct is malicious if it is accompanied by ill will, or spite, or if it is for the purpose of injuring another. Conduct is in reckless disregard of plaintiff's rights if, under the circumstances, it reflects complete indifference to the safety and rights of others. The jury determines whether and in what amount punitive damages are awarded. There are instances when judicial intervention is appropriate, as states are lending credence to the notion that the punitive damage award must be in proportion to the compensatory damages received by the plaintiff.

## **Risk Management and Insurance**

Product liability law is an unavoidable fact for product manufacturers. Effective product liability risk management should be an essential part of every business plan, and should permeate all planning, design, development, manufacturing and marketing activities. Specific product liability risk management needs will, of course, vary with the size of the manufacturer or seller and nature of the products, but the following is a list of some basic considerations:

### **Risk Management Before the Lawsuit**

#### ***Review and Instruction***

The best time to address product liability risks is before any lawsuits arise. Review of business practices, warnings and documentation by a risk management professional is valuable, as is product liability “sensitivity training” of company employees.

#### ***Document Creation***

The scope of discovery is broad and, in the end, nearly every document in a manufacturer's possession, custody or control is discoverable and may eventually wind up before a jury. Documents must therefore not be recklessly drafted, and issues of concern which are raised in documents should be resolved in documents.

#### ***Document Management and Retention***

Product liability lawsuits are document intensive. Documents which are retained for business purposes should be systematically maintained. Consideration should be given to adopting a record retention policy which provides an enforceable and verifiable system for the regular disposing of documents which no longer need to be maintained for any business purpose and retention of documents when litigation has commenced. Retention and disposal of electronic and hard copy documents have been the subject of many pre-trial disputes and if not appropriately managed and documented, can have significant monetary consequences.

#### ***Contractual Indemnification***

For sellers, component or other manufacturers, and suppliers, indemnity provisions should be incorporated in contractual documents regarding the manufacture, design or sale of products. The availability of indemnity clauses will be on a case-specific basis. Manufacturers and sellers are encouraged to contact counsel to review all agreements, purchase orders, quotations and the like prior to the design, manufacture, sale or distribution of a product. In many instances, the presence of an appropriate contractual indemnification clause can significantly reduce and/or eliminate litigation risks.

## **Risk Management after the Lawsuit is Filed**

### ***Selection of Counsel***

There is a difference in approaches, styles and quality. Insurance companies may reserve selection of counsel (a negotiable term), but may have a list of approved counsel from which an insured may select.

### ***Selection of Company Representative***

Counsel should assist in selecting a company representative to testify and otherwise represent a company at trial. Jurors observe company representatives on the witness stand, at counsel table, and in the coffee shop down the street from the courthouse.

### ***Avoid the “Discovery Tort”***

Abuse of the discovery process by plaintiffs in product liability cases is common, but corporate defendants must remain diligent in responding to unreasonable court-ordered discovery. Failure to do so may result in sometimes devastating sanctions, such as entry of a default (a finding of liability).

### ***Insurance***

Product liability insurance is now a routine cost of doing business. Product liability coverage is extremely common and is obtained by nearly every manufacturer as part of their general liability coverage. While extremely large companies may have a self insured retention with excess coverage, small and medium size companies can and do obtain “first dollar” primary coverage for both indemnity and defense, with excess umbrella coverage as needed.





### Overview

#### *Civil versus criminal litigation*

This booklet deals with civil litigation. It does not discuss criminal litigation.

#### *State versus federal courts*

Whether lawsuits are filed in state or federal court depends on a number of factors including the subject matter of the action and the citizenship of the parties.

#### *Plaintiff versus defendant*

The plaintiff is the party that is suing. The defendant is the party that is being sued.

#### *Steps of a civil case*

Broadly speaking, a civil case consists of four phases:

- (1) pleadings
- (2) discovery
- (3) trial and judgment
- (4) post-trial

### Pleadings

Pleadings are written claims and defenses that establish who is suing whom, what is in controversy, and on what grounds the action is being based.

### Complaint

A civil lawsuit is initiated when the plaintiff's attorney files a complaint with a court. The complaint states how the plaintiff has been harmed, what the defendant did to cause that harm, and what remedy the plaintiff is seeking. Among other things, the plaintiff may seek money, a declaration of the parties' rights and obligations, or an injunction requiring the defendant to act, or to stop acting, in a certain manner.

### Summons

The plaintiff is required to serve the defendant with a summons and the complaint. The purpose of the summons is to give the defendant notice that a complaint has been filed and that a response to the complaint must be made. Once the defendant has been served with the summons and complaint, he must answer or otherwise respond to the complaint within a specified time. If the defendant fails to timely respond to the complaint the court may enter a default judgment in favor of the plaintiff.

### Initial Motions

#### *Motions to dismiss*

Sometimes the defendant's first response will be a motion to dismiss. Such motions may be based on a number of grounds including the complaint's failure to state a claim upon which relief can be granted, the court's lack of jurisdiction over the defendant or the controversy, or the failure of the plaintiff to bring the action in the right venue.

#### *Motions to transfer*

Sometimes the defendant will seek to have the action transferred to another court on convenience grounds or on the grounds that the action has been brought in the wrong venue.

#### *Motion for more definite statement*

Such a motion is filed when the complaint is so vague or ambiguous that the defendant cannot frame a responsive pleading.

#### *Motion to strike*

Occasionally such motions are filed in an attempt to have the court strike from the complaint redundant, immaterial, impertinent, or scandalous matter.

Motions are filed with the court and served upon the lawyer for the opponent. They are filed with a brief or memorandum containing citations to the law and facts. The opponent is given an opportunity to file an opposing brief.

### Answer

If the defendant does not file a motion to dismiss, its first step will be to file and serve an answer. The answer responds to the factual allegations in the complaint.

Generally, the answer must state any affirmative defenses that the defendant intends to use against the plaintiff's claims. A failure to timely state an affirmative defense may prevent the defendant from asserting it later on during the case including the trial.

### Counterclaim

If the defendant has a cause of action against the plaintiff, he must assert it in a counterclaim. The counterclaim usually is filed along with the answer.

### Cross-claim

The defendant may make a cross-claim against another defendant.

### Joinder of Additional Parties

Additional parties other than the original plaintiff and defendant may be joined and made subject to the counterclaims, cross-claims, and third-party claims.

## **Discovery**

After the initial pleading stage, the attorneys attempt to uncover evidence supporting and refuting the claims and defenses. This is called discovery. There are a number of formal discovery devices, including the following:

### ***Depositions***

Depositions are oral questions asked by the lawyer for one of the parties. The person being deposed is called a deponent. The deponent must answer the questions under oath. Most depositions are recorded by a court reporter, but some are recorded by video. The deponent should have his or her lawyer present during the deposition.

The deponent's lawyer should carefully prepare the deponent prior to the deposition. A deposition creates an excellent opportunity for the deponent to lose the case. A deponent should answer only the question and nothing more. Saying too much can sometimes destroy a deponent's case. The deponent should not lie. The other side will likely use the most innocuous of lies to convince the jury that the deponent probably is lying about the important facts as well.

Depositions usually are more expensive than other forms of discovery because of travel expenses, court reporter costs, and preparation time. However, depositions often yield responses that are more candid than the responses that typically result from other discovery mechanisms, since the deponent is forced to answer questions with limited time for reflection and without the active assistance of counsel. Depositions are also advantageous because they allow the deposing lawyer to immediately ask numerous follow-up questions.

### ***Interrogatories***

Interrogatories are written questions. They are usually answered by lawyers, but signed under oath by their clients. Because lawyers usually draft the answers, interrogatories generally are not very good devices for obtaining candid information with respect to important, contested issues. Interrogatories are most useful in discovering the names and addresses of witnesses, the location of documents, and the like.

## **Requests for production of documents and things and entry upon land for inspection and other purposes**

Such requests are made in writing.

### ***Requests for admission***

These are written requests that a party admit or deny matters that relate to statements or opinions of fact, or the application of law to fact. A matter is deemed admitted if it is not timely denied in writing.

## ***Discovery is easy to initiate and can be highly intrusive and expensive***

Permission from the court is almost never needed for a party to take discovery. In addition, a party need not limit his discovery to information and documents that are "relevant." To the contrary, a party can seek to discover information and documents that are "reasonably calculated to lead to the discovery of admissible evidence." Accordingly, your opponent may be able to discover many of your secrets. For example, your opponent may be able to discover your internal and external email, written memoranda, and other correspondence; your handwritten notes; your calendars; your financial documents and tax returns; your business plans; and your personnel records.

If the opponent's discovery requests are too intrusive, your lawyer should file written objections or a motion for a protective order. If the opponent fails to produce discovery, your lawyer should file a motion to compel discovery. Discovery disputes can be very expensive. The court may impose sanctions upon a party that fails to comply with discovery requests. Sanctions can take many forms including an order:

- That certain matters be deemed established
- Refusing to allow the disobedient party to support or oppose designated claims or defenses
- Prohibiting a disobedient party from introducing certain matters into evidence
- Striking out portions of pleadings
- Dismissing all or part of a complaint or entering a judgment of default against the disobedient party
- Holding the disobedient party in contempt of court
- Requiring the disobedient party or his lawyer to pay expenses and attorney fees caused by the failure to produce discovery.

## **Conclusion of Litigation Without Trial**

The vast majority of lawsuits never go to trial.

Most cases are settled before they get to trial. In the event of settlement, the defendant should obtain a dismissal of the action with prejudice. A dismissal with prejudice bars the plaintiff from ever pursuing the action again. A dismissal without prejudice allows the plaintiff to pursue the action at a later date. In the event of settlement, the defendant should also require the plaintiff to sign a release. A release is an agreement that the plaintiff will never bring another suit based on the matters in dispute.

Sometimes the pleadings and evidence gathered during discovery establish that there is no genuine issue of material fact to be tried. In that event, the judge enters a summary judgment upon motion by one of the parties.

## Trial and Judgment

If the case is not settled or dismissed by the court, it proceeds to trial. The United States Constitution grants a right to jury trial for common law actions. A party is not entitled to have a jury decide actions that originally were brought in equity courts, however. A party can waive a right to jury trial by failing to timely notify the court of the exercise of that right. Most civil trials consist of juries comprised of six ordinary citizens.

A civil trial usually follows this sequence:

- (1) Selection and swearing in of jurors
- (2) Opening statement by the plaintiff's lawyer
- (3) Opening statement by the defendant's lawyer
- (4) Presentation of evidence by the plaintiff's lawyer
- (5) Presentation of evidence by the defendant's lawyer
- (6) Closing argument by the plaintiff's lawyer
- (7) Closing argument by the defendant's lawyer
- (8) Rebuttal argument by the plaintiff's lawyer
- (9) The judge's instructions to the jury
- (10) The jury's deliberations

After the plaintiff has presented evidence, but before presentation of the defense, the defendant may move for a dismissal due to the plaintiff's failure to present sufficient evidence in support of his claims.

A judgment or decree is issued in favor of the party found to have met its burden of proof.

## Post-trial

After the judgment or decree, the losing party has several options:

### *Post-trial motions*

Such motions can request a number of forms of relief including a judgment in the loser's favor notwithstanding the verdict that was reached by the jury, a new trial, or a reduction in damages.

### *Satisfaction of the judgment*

A judgment is a court order requiring the losing party to provide satisfaction in some manner to the prevailing party. Satisfaction may take several forms. For example, the losing party may be required to pay monetary damages and court costs to the prevailing party, to perform a specified action, or to cease certain conduct.

If the prevailing party wishes to recover court costs, he must submit for the court's approval a statement of all recoverable expenses incurred in the course of litigation. The opposing party may object to the requested costs.

Each side normally is responsible for its own attorneys' fees. There are some limited exceptions to this rule, however. Once satisfaction has been made, a document must be filed with the court indicating that the judgment has been satisfied.

### *Failure to satisfy the judgment*

If the losing party fails to satisfy the judgment, the prevailing party will have to take measures to enforce it. This can include attachment of the losing party's property.

### *Appeal to a higher court*

If the losing party chooses this option he must make the appeal within a specified period of time. If he fails to do so he will lose the right to appeal.

## Why those with little or no money can afford to retain lawyers and sue

The loser rarely has to pay the winner's attorneys' fees and expenses. The plaintiff's lawyer sometimes is paid solely through a percentage of any recovery. This is frequently 1/3 of the recovery before reduction of expenses. In contrast, the defendant's lawyer almost always is paid by the hour. Class action lawsuits allow hundreds or thousands of persons with small claims to combine their lawsuits into one. The lawyers who bring class actions typically are paid out of any recovery.



## Juries

Many highly complex business issues are decided by juries with no knowledge, training, or experience in the subject matter at issue.

Juries sometimes impermissibly reach decisions based on emotional considerations and biases.

## Avoiding or reducing the cost of litigation

### *Insurance*

Consider obtaining insurance to protect your company from the risks associated with litigation.

**Alternative dispute resolution (e.g., arbitration or mediation)**

**Advantages:** usually less expensive because it avoids jury trial, extensive discovery, and appeal.

**Disadvantages:** you may end up wanting a jury trial, extensive discovery, and the right to appeal.

Both sides must agree to resolve their disputes outside of court. “Magic language” is required. If possible, get your employees, customers, suppliers, etc., to agree to this in writing before there is any dispute. If you wait until there is a dispute, the other side may refuse to agree to alternative dispute resolution.

## **Working with your lawyer to reduce litigation costs**

### ***Consult with a lawyer before a dispute arises***

Avoid verbal agreements or contracts drafted by non-lawyers. Consider having a lawyer review projects, products, work environments, document retention policies, procedures for handling privileged and confidential information, corporate deals, warranties, employee policies, employment agreements, and other contracts with an eye towards avoiding litigation or placing the company in the strongest possible position should litigation arise. Such consultations usually are very inexpensive when compared to the costs and other risks associated with litigation.

### ***Educational programs***

Ask a lawyer to provide educational programs to alert and sensitize employees to the litigation process and to avoid “smoking guns” from being created in the first place. Some lawyers will agree to do this at no cost.

### ***Actively assist your lawyer***

Don’t hand the complaint to your lawyer and walk away. You can reduce litigation costs, and enhance your chances for success, by providing substantial assistance to your lawyer right from the beginning.

Actively assist your lawyer in identifying documents and potential witnesses. Gather all relevant documents and provide them to your lawyer.

Immediately tell your lawyer the whole truth and insist that your employees do so as well. Withholding documents and information from your lawyer can destroy your chances for success. Surprise is your lawyer’s worst enemy. It is expensive. Remember, your communications with your lawyer are privileged and confidential if you treat them as such.

Consider attending important depositions to assist your lawyer with follow-up questions. Your attendance may serve as a “truth serum.”

Review the opponent’s court filings, interrogatory responses, documents, deposition transcripts, and the like, and discuss them with your lawyer.

Generally, the more active your involvement in the litigation, the better your chances for success. You know the facts better than anyone.

### ***Consider settlement early and often***

By and large, over 90 percent of all civil cases ultimately settle. However, many companies do not consider settlement as a viable option until shortly before trial. By that time the company usually has already invested a significant amount of time and money in the litigation. Therefore, you should periodically assess the settlement value of the case throughout the litigation. Such assessments can be made before the litigation commences, at the pleadings stage, at periodic intervals throughout discovery, shortly before preparation of motions to dismiss or for summary judgment, after such motions have been filed, after such motions have been decided, at the commencement of trial, and while post-trial motions and appeals are pending.

## **Antitrust**

### **Overview**

U.S. antitrust laws apply to all non-resident aliens who conduct business in the United States. Because U.S. antitrust laws are exceedingly complex and do not differentiate between foreign, domestic or transnational entities, the discussion about these laws outlined below is fairly introductory and general.

### **General Principles**

In general, there are three United States federal laws that define the antitrust policies of primary interest to foreign investors in the United States. These are the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.

Most states also have their own antitrust laws which can reach anti-competitive activities in their individual states. To make matters even more complicated, the individual State Attorneys General do not always accept published federal antitrust guidelines or federal court decisions approving certain types of conduct under the U.S. antitrust laws. Consequently, in recent years criminal and civil actions are being brought in state courts for activities which under federal antitrust law would be permissible.

This focuses on the U.S. federal antitrust laws.

Inbound investments, and particularly inbound joint ventures, are of particular interest to U.S. antitrust authorities. Because U.S. antitrust laws exist to protect U.S. consumers and markets, ventures or U.S. subsidiaries of foreign nationals that exist to serve the U.S. market or to fence the U.S. market off must comply with U.S. antitrust laws, primarily Section 1 of the Sherman Act and Section 7 of the Clayton Act. The language of these statutes provides virtually no guidance and the prohibitions of Section 1 of the Sherman Act or Section 7 of the Clayton Act can only be found by an examination of the precedent that has evolved since the Sherman Act was first adopted in 1890. Because antitrust law is so fact-dependent, a small variation in facts can make all the difference in whether particular conduct is prohibited or not.

One important aspect of U.S. antitrust laws is that private persons injured in their business as a result of violation of the antitrust laws may sue for treble damages if they have suffered “antitrust injury.” As a consequence, before entering agreements which might violate the antitrust laws, foreign investors are well advised to focus on private cases as well as government action.

### **The Sherman Act**

The Sherman Act takes a very broad approach and prohibits anti-competitive practices in almost all lines of interstate commerce. Section 1 prohibits contracts, combinations and conspiracies in restraint of trade.

Two elements are required for liability under Section 1, an agreement plus a prohibited restraint of trade. Precedent makes it clear that certain types of agreements are deemed illegal “per se” because of their pernicious effect on competition. These per se rules are generally confined to agreements among competitors at the same level of distribution. Price fixing, allocation of markets or customers, and similar agreements among competitors fall in the per se category if they in any way force consumers to pay more for fewer goods. Per se offenses are treated so stringently under the Sherman Act that the reason for the usage of such agreements is irrelevant; the fact that such an agreement might make safer cars, or would provide better medical care, is of no consequence. Agreements between non-competitors can also be proscribed if either of the agreeing firms might be a potential competitor in a particular line of business even if currently it is not an actual competitor.

Other types of agreements are judged under a “rule of reason” standard which entails a full examination of the purposes and competitive effect of the agreement. Under the rule of reason,

the business justifications and any pro-competitive effects of an arrangement are balanced against any perceived anti-competitive effects.

### **The Clayton Act**

In contrast to the Sherman and FTC Acts, the Clayton Act specifically designates practices or transactions which are prohibited. Of particular interest to foreign investors are the provisions of Section 7 of the Clayton Act which specifically condemn mergers, acquisitions of stock or assets, and joint ventures that might have harmful effects on competition. The Clayton Act covers actions which “may” lead to anti-competitive effects so it is a more far reaching restriction than Section 1 of the Sherman Act which requires that actual anti-competitive effects be shown. If the proposed acquisition or joint venture is large enough, then the early reporting requirements of the Hart-Scott-Rodino Act may apply as discussed below.

### **The Federal Trade Commission Act**

The Federal Trade Commission Act also has broad application. It includes conduct which constitute violations of the Sherman Act or the Clayton Act, as well as conduct that is unfair or deceptive, even though it is not specifically condemned by the other Acts. The Federal Trade Commission Act prohibits interactions which are simply anticipated, even though it does not reach the full-blown conclusions of the Sherman Act. In other words, it prohibits conduct in the incipient stage, even though it is not yet a full-blown violation of either the Sherman Act or the Clayton Act.

### **The Hart-Scott-Rodino Antitrust Improvements Act of 1976**

This HSR Act was adopted to assist the antitrust authorities in examining mergers, acquisitions and joint ventures which meet certain thresholds before they are consummated.

### **Coverage**

The HSR Act requires notification filings and imposes a designated waiting period with respect to any acquisition of assets or voting securities (including mergers and joint ventures) if certain tests are met.

#### ***Size-of-Person Test*<sup>1</sup>**

This test generally requires that the ultimate parent entities (defined as the acquiring person and the acquired person) of the parties have annual net annual sales or total assets of at least \$126.2 million for one of the parties and \$12.6 million for the other. However, if the size of the transaction exceeds \$252.3 million, the transaction is reportable without regard to the size of the parties.

### ***Size-of-Transaction Test***<sup>2</sup>

This test requires that the acquiring person will hold assets or voting securities of the acquired person as a result of the acquisition valued at more than \$63.1 million.

### ***Commerce Test***

This test requires that at least one of the parties is engaged in interstate commerce or an activity affecting interstate commerce. This test is usually broadly construed such that any party to a transaction is likely to meet this test.

The HSR Act and regulations contain extensive technical rules for applying the tests (including special rules in the case of joint ventures and foreign businesses) and also include exemptions for certain acquisitions.

### **HSR Notification**

If notification is required, all parties must submit the required information on the prescribed form and return two notarized copies to the U.S. Federal Trade Commission and three notarized copies to the U.S. Department of Justice. In general, the information required includes the identity of the parties, the structure of the acquisition and certain documents as to the parties including balance sheets, other financial information and certain planning and evaluation documents.

The notification form also requires the parties to report revenue information by North American Industry Classification System (2007 NAICS Codes), and whether there is overlap between the parties. The acquiring person must also include information as to acquisitions during the past five years. Additional data is required in the case of the formation of a joint venture.

A filing fee is required based on the value of the transaction. The minimum filing fee, applicable to transactions valued under \$126.2 million, is \$45,000. Higher filing fees apply to transactions exceeding that amount. These transaction values are indexed like the coverage thresholds and are subject to change.

- 1 - The dollar thresholds are revised annually based on the change in the U.S. gross national product. The above thresholds are current as of January 1, 2009.
- 2 - The dollar thresholds are revised annually based on the change in the U.S. gross national product. The above thresholds are current as of January 1, 2009.

A thirty-day waiting period then applies before the transaction can be consummated. The waiting period can sometimes be shortened by requesting early termination or may be lengthened by the FTC or the DOJ requesting additional information.

Failure to file the requisite Hart-Scott-Rodino filing prior to the consummation of a transaction covered under the Act (including the formation of a joint venture) can result in substantial penalties which have been enforced very strenuously in recent years.

### **Enforcements and Penalties**

Violations of the antitrust laws can lead to extremely severe penalties and enormous financial expense. It can always have serious criminal consequences. Certain offenses are criminal felonies punishable, in the case of individuals, with imprisonment of up to three years. The maximum fine for individuals is \$1,000,000 and in the case of corporations, these violations are punishable by fines of up to \$100,000,000. Fines in excess of the statutory maximum may also be imposed pursuant to 18 U.S.C. 3571(d).

### **Antitrust Guidelines for Collaborations Among Competitors**

These Guidelines cover joint ventures of any size and may even go so far as to cover simple joint ventures pursuant to patent licenses. The Guidelines were issued by the FTC and the Justice Department in late 1999. All antitrust issues are inherently fact-related. Bright line guidance is not possible. On certain issues the National Association of Attorneys General has stated that they do not accept the Guidelines which means that compliance with the rules is difficult to determine without extensive investigation.



### Introduction

The term “dissolution” refers to the true ending of a company's legal existence for purposes of conducting business. The following is a general outline of procedures and considerations involved in dissolving corporations and limited liability companies – the two most common businesses used by foreign entities to conduct business in the United States.

This focuses on common rules, based largely on the various model statutes used by state legislatures to draft specific laws in their states. Rules vary from state to state. A qualified attorney should be engaged before beginning the dissolution of a business entity.

### Corporations

A corporation can be dissolved in several ways. It can be dissolved voluntarily by the board of directors and shareholders of the corporation, upon the happening of an event specified in the articles or certificate of incorporation, judicially by a court, or automatically under certain circumstances. In some cases, the dissolution of a corporation can be revoked prior to the complete distribution of the corporation's assets.

### Voluntary Dissolution

A corporation may be voluntarily dissolved by its board of directors and shareholders. To do so, the board of directors must first approve a dissolution plan at a meeting or by written consent and then submit the plan to the shareholders. In some states, the board of directors must recommend approval of the dissolution to the shareholders, unless the board determines that, due to a conflict of interest or other special circumstances, it should not make a recommendation. Next, the shareholders must approve the dissolution at a meeting called for that purpose or by written consent. In some states, a corporation can be dissolved by written agreement of the shareholders without approval of the board of directors.

After the dissolution is approved, a certificate of dissolution must be filed with the appropriate governmental entity. The filing establishes the date and time when the corporation is dissolved and must begin winding up its business. Technically, the “existence” of the corporation continues notwithstanding dissolution for the purposes of winding up and liquidating the business.

### Judicial Dissolution

A corporation can be judicially dissolved at the request of the State government, a shareholder or a creditor. The court may order dissolution if a sufficient basis for dissolution exists.

#### *Action by State government*

The State where the corporation was incorporated can bring an action in court to dissolve the corporation on the grounds that the corporation was fraudulently organized or repeatedly and willfully conducted its business in violation of the law.

#### *Action by directors or shareholders*

The directors or the shareholders may bring an action if the directors are unable to agree by vote on material matters regarding the management of the corporation, the shareholders are unable to elect directors for the corporation, the directors have acted in an illegal, oppressive or fraudulent manner, or the corporate assets are being misapplied or wasted.

After a court order has been entered, the court will direct the corporation to wind up its affairs and liquidate its business.

### Automatic Dissolution

A corporation may be automatically dissolved for failing to file and pay franchise taxes or reports or to take other specified actions and upon the expiration of its corporate term if not perpetual.

#### *Administratively*

A corporation may be automatically dissolved for a variety of reasons, usually including failing to pay franchise taxes or fees, file annual reports, designate or maintain a statutory agent, or otherwise to comply with specific state requirements. A corporation which has been administratively dissolved usually may apply for reinstatement within a specified time frame after dissolution.

#### *Expiration of corporate term*

If a corporation has selected a fixed corporate term in its articles or certificate of incorporation, rather than a perpetual term, it will be automatically dissolved when the corporate term expires. No dissolution filing is required.

### Effect of Dissolution

A dissolved corporation continues to exist as a legal entity, but may not carry on any business except as may be appropriate for winding up and liquidating its business and affairs. The permitted types of activities include the following:

- Collecting assets
- Disposing of properties that will not be distributed in kind

- Discharging or making provision for discharging liabilities
- Distributing its remaining property to its shareholders according to their interests
- Doing anything else necessary to wind up and liquidate.

The dissolution of a corporation *does not*, however, do any of the following:

- Transfer title of the corporation's property
- Prevent transfer of its shares or securities
- Subject its directors or officers to a different standard of conduct
- Change quorum or voting requirements for its board of directors or shareholders
- Change provisions for selection, resignation or removal of its directors or officers or both, nor change provisions for amending its bylaws
- Prevent commencement of a proceeding by or against the corporation in its corporate name
- Abate or suspend a proceeding pending by or against the corporation on the effective date of dissolution
- Terminate the authority of the registered agent of the corporation.

### **Payment or Provision for Claims and Distribution of Assets after Dissolution**

The corporation must, as a part of its dissolution, make adequate provision for the payment of its creditors prior to making any distribution of assets to its shareholders. After either payment or adequate provision for payment to the corporation's creditors has been made, the remaining assets can be distributed to the corporation's shareholders according to their respective rights and interests. The directors may be personally liable for the amount of the distributions if assets are distributed without first having made adequate provision for the corporation's creditors as required by the statute. A shareholder who receives a dissolution distribution with knowledge that it is contrary to these requirements may also be liable for the distribution received.



### **Barring Claims**

There usually are procedures for a corporation to dispose of the known claims of creditors by notifying those claimants in writing of its dissolution after it becomes effective. Failure of the creditor to assert a claim against the corporation, within a specified time period after it has received notice of the corporation's dissolution will bar the creditor from later asserting its claim. Additionally, a dissolved corporation may be able to bar all creditors, known and unknown, that do not file claims within a specified period of time by publishing a notice of the dissolution in a newspaper which meets specific circulation requirements.

### **Limited Liability Companies**

A LLC may be dissolved in any of the following ways:

- By expiration of the term of the LLC (as stated in its charter documents);
- The happening of events specified in its articles of organization or its operating agreement
- By a written consent of the members
- By the entry of a decree of judicial dissolution.

Unlike a corporation, a certificate of dissolution is not required to be filed for the LLC to be dissolved although upon completion of the winding up of the LLC's business and affairs, a certificate of cancellation is to be filed. See below.

### **Effect of Dissolution**

Upon dissolution, the LLC must begin winding up its business and affairs. As with a corporation, the winding up process generally involves selling the assets and satisfying the debts of the LLC and distributing the remaining assets to the members of the LLC. During this winding up process, the managers or members who manage the LLC generally have the authority to engage in activities that are appropriate for winding up. Some of the LLC statutes enumerate the following activities as appropriate in winding up the LLC:

- Prosecuting and defending suits
- Settling and closing the business of the LLC
- Disposing of and transferring the property of the LLC
- Discharging the liabilities of the LLC
- Distributing to the members any remaining assets of the LLC
- Preserving the LLC business or property as a going concern for a reasonable time
- Settling disputes by mediation or arbitration.

Additionally, in some states, an LLC, similar to a corporation, may be able to give notice to creditors or publish a notice of the dissolution in order to bar claims of creditors if the LLC follows the procedures specified in the applicable statute.



## Dissolution Procedures

A LLC is dissolved and its affairs wound up in a fashion similar to that of a corporation. The winding up process involves selling off the assets of the LLC, satisfying the debts to creditors and making distributions to the members. The assets of the LLC are distributed first to its creditors, second, to its members who may be owed any past or current distributions, and finally, any remaining assets are distributed to the members in accordance with their share of the LLC.

As with a corporation, distributions to members that are made without adequately providing for the creditors of the LLC can result in liability to the LLC. A manager of the LLC who votes for, or a member who assents to, an improper distribution can be held liable to the LLC for the amount of the distribution that was improperly made.

## Cancellation of Articles of Organization or Certificate of Formation

Once the winding up of the LLC is completed, a certificate of cancellation is filed with the appropriate governmental authority in the state where the LLC was organized. The filing of the certificate of cancellation will cancel the legal existence of the LLC.

## Other Considerations

Any time you consider closing a business, there are several areas that you should consider reviewing with your legal, tax and accounting professionals:

- Tax consequences and final federal, state, and local tax returns and payments
- Outstanding obligations under contracts and other binding commitments (including bank financing arrangements)
- Employment issues, including obligations under employee benefit plans, severance arrangements, COBRA (continuing health care obligations) and WARN Act (plant closing notification requirements) responsibilities
- Disposition and protection of intellectual property.
- Payment or provisions for payment of known and contingent liabilities and the effect of not paying or performing those liabilities
- Selling and liquidating the company's assets
- Withdrawing from doing business in other jurisdictions.

The logo for Miller Canfield, featuring the name in a large, bold, serif font. The word "MILLER" is positioned above "CANFIELD", and the letters are closely spaced.

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1. The Restatement (Second) of Torts §402A do not directly address the applicability of the rule to sellers of used products. Courts in different jurisdictions have applied the theory based on case-specific interpretations of the policy considerations behind strict liability.
  2. For purposes of this booklet, we will discuss the two primary tests.
  3. The consumer expectations test has been applied to a variety of product liability actions, including manufacturing and design defects, breach of warranty and pure design defect cases. For purposes of this booklet, the consumer expectations test will be discussed in the context of design defect cases only.
  4. The dollar thresholds are revised annually based on the change in the U.S. gross national product. The above thresholds are current as of February 28, 2008.
  5. The dollar thresholds are revised annually based on the change in the U.S. gross national product.

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The United States Federal tax advice contained herein, if any, may not be used or referred to in the promoting, marketing or recommending of any entity, investment plan or arrangement, nor is such advice intended or written to be used, and may not be used, by a taxpayer for the purpose of avoiding Federal tax penalties. Advice that complies with Treasury Circular 230's "covered opinion" requirements (and thus, may be relied on to avoid tax penalties) may be obtained by contacting the author.

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