



AbdulJaami, PLLC  
International Commercial Transactions

# Growing Your Export Operations

Using Advance Planning to  
Maximize Profits



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# Growing Your Export Operations

- Stage 1: Low Volume/Lack of International Trade Experience
  - Export products through independent brokers or distributors
    - Payment of commission or decreased sales revenues
    - Less control over sales and distribution
- Stage 2: Increased Volume/Some International Trade Experience
  - Establish in-house foreign marketing division
    - Use U.S. employees or foreign nationals to perform marketing, sales and support functions
- State 3: Established Exporter/Experienced in International Trade
  - Establish foreign liaison office
    - Generally handles advertising and marketing functions but does not participate in the selling or distribution process
  - Establish foreign branch sales office
    - Handles advertising, marketing, selling and distribution
  - Form foreign subsidiary



# Exporting Intellectual Property: Licensing and Franchising

- Benefits
  - Quickly establish presence in foreign country
- Downside
  - Lower profit margins
  - Potential loss of control
    - Quality
    - Image
- Basic Process
  - U.S. company secures foreign Intellectual Property rights
  - U.S. company licenses those rights to foreign business
  - U.S. company receives a percentage of the foreign business' sales in the form of a royalty



## Export Operations: Basic Tax Issues

- Exports through independent distributors
  - Because there is no taxable presence within the foreign country, there are no opportunities for foreign tax reduction planning
  - However, the exporter may be subject to foreign taxation in the future and may therefore benefit from foreign tax credit planning (two year carry back)
  - Pass title abroad to generate foreign-source income
- Exports using exporter's sales force
  - No foreign taxable presence, therefore no opportunities for foreign tax reduction planning
  - The presence of exporter's sales force in the foreign country may expose the exporter to foreign taxation



## Export Operations: Basic Tax Issues

- Exports through foreign sales office
  - Decision whether to structure operations under a branch office or a subsidiary
  - Determination of taxable income for purposes of foreign taxation
  - In general, as the foreign sales office performs more functions and assumes more risk, more profit should be allocated to it
- Licensing and Franchising
  - Appropriate foreign withholding tax rate on royalty income
    - Most income tax treaties provide for reduced withholding rates on royalties



## Foreign Branch Office or Subsidiary?

- Branch Office
  - Characteristics
    - An unincorporated overseas office; not a separate entity
    - Unless the branch office is deemed to be a permanent establishment, earnings not subject to foreign taxation
      - In some instances, remittances of earnings to U.S. parent will be subject to a branch profits tax
    - Regarding timing, earnings taxed similarly to domestic earnings; foreign tax credits apply
    - Branch office losses can be used to offset to U.S. parent profits
  - Advantages
    - Transfers
      - Tax-free transfers of assets from the U.S. parent to the branch office
    - Repatriation of earnings
      - Potentially free of foreign taxation



# Foreign Branch Office or Subsidiary?

- Subsidiary
  - Characteristics
    - Incorporated under foreign country's law; separate entity
    - Earnings subject to foreign taxation
      - Distributions to U.S. parent likely to be subject to withholding tax
    - U.S. will not tax earnings until they are repatriated (distributed to U.S. parent as a dividend)
      - Some foreign earnings that are not repatriated may be taxed
    - Subsidiary losses may not be used to offset U.S. parent profits
  - Advantages
    - Control
      - U.S. parent can choose when to repatriate earnings and therefore when to pay U.S. taxes
    - Local Benefits
      - Foreign incorporation may result in the ability to take advantage of local benefits such as tax holidays, capital-raising



## Foreign Branch Office or Subsidiary?

- Other Considerations
  - Ease of Implementation
    - A branch office may be easier to set-up and operate
      - Ease of set-up may come with restrictions
  - Legal Liability
    - A foreign subsidiary may insulate the U.S. parent from foreign legal liability and U.S. legal liability
      - Example: Under the Foreign Corrupt Practices Act, a U.S. parent is not liable for certain foreign subsidiary actions
  - Raising Capital
    - A foreign subsidiary facilitates the in-country raising of capital through the sale of shares
    - A branch office may not be subject to foreign minimum capitalization laws



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