

# E stablishing a

In less than two years, our company went from having one office in Boston to having more than 20 offices around the world. As corporate counsel for Grand Circle L.L.C., an international travel company, we have been involved in creating these offices, primarily in Europe and Asia, where we have dealt with both civil law and common law rules.<sup>1</sup> Despite the many differences in corporation law among these jurisdictions, it became clear to us that, no matter where we opened an office, we could effect the same basic procedure. The process is similar enough in each country to permit the development of a uniform checklist.

To establish a company office in another country, we believe counsel must observe these six steps:

- Engage a local person.
- Retain local counsel.
- Perform preliminary legal work.
- Make structural decisions.
- Determine office governance.
- Formalize the relationship between the office and the parent company.

We will explore the issues that counsel must consider and the actions that he or she must take at each of these steps. In so doing, we think you will see that establishing a foreign presence is a relatively straightforward project, and more importantly, you will understand how to begin the project and what steps to take to complete it in a timely and efficient manner.

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# Presence

# Company



# Around the World

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## GRAND CIRCLE MODEL

Certain details about our company's globalization bear mentioning. First, our industry, travel and tourism, is regulated in most countries. Accordingly, we had to apply for and receive a license to provide and/or sell travel and tourism services in-country. Our operations then became subject to the regulations of the local tourism board. In some countries, the licensing requirement limited or dictated our personnel and structural decisions. Although we discuss the considerations that counsel opening a foreign office in a regulated industry must confront, this discussion should not detract from our article's applicability to nonregulated industries.

Second, our company simultaneously opened more than 20 offices in 18 countries worldwide, and all of these foreign offices are operationally identical. Our office in Paris, for example, performs the same services in France for our company that our office in Bangkok performs in Thailand. This article describes the process for opening a single office. You can apply it whether you are opening a number of operationally identical offices simultaneously, as we did, or one foreign office.

Third, before we started this process, our company already had a substantial international presence. Grand Circle is one of the leading adventure travel providers in the United States for people over age fifty. The business currently generates more than \$400 million in revenue and employs more than 2000 people. In the past, our Boston office planned and marketed trips, but local ground tour operators worldwide delivered the services to travelers. With the company's growth came the need to have better control over the service and, hence, our decision to go global. This decision entailed, in essence, setting up statutory legal entities—subsidiary companies or branch offices—in all of the foreign jurisdictions where we were to hire people.

The volume of our business had increased to the point that it became more cost-effective for us to open our own offices, rather than to use third-party providers. Also, the company wanted more control over the sourcing of goods and delivery of the end product. The process of going direct raises its own unique issues, such as the termination of existing arrangements with foreign agents, that are not addressed in this article. In general, the termination

## THE VOLUME OF OUR BUSINESS HAD INCREASED TO THE POINT THAT IT BECAME MORE COST-EFFECTIVE FOR US TO OPEN OUR OWN OFFICES, RATHER THAN TO USE THIRD-PARTY PROVIDERS.

of a long-standing relationship, particularly one in which the third party has developed an economic dependence, will require some meaningful notice and often, in civil law countries, a statutorily mandated indemnity payment.<sup>2</sup> You should consult local counsel before you give notice of termination. You can successfully apply the procedure we outline in this article, however, whether you are transitioning, as we did, or expanding from a strictly U.S. presence to an international presence.

Fourth, we should note that our company is privately held. Operating issues differ for foreign offices, depending on whether the parent company is public or private, but the initial startup of any office should be the same. Public companies have additional disclosure requirements about foreign subsidiaries, but they are beyond the scope of this article.

We developed this process to work with the particular business model and global strategy of our company. It assumes, as we did, that you have already made the decision to expand globally and that your foreign offices will provide services to your company, such as directly sourcing cost of goods or delivering services to existing customers, rather than sell your company's goods to overseas customers.<sup>3</sup> (Currently, we make all of our sales in the United States to American consumers.) It also assumes that you have decided to create a direct presence by opening your own offices, rather than by contracting with third-party providers, for agency or distribution,<sup>4</sup> joint ventures, licensing, or franchising,<sup>5</sup> and that you have only one parent company, rather than a joint venture or a partnership.

There are, as mentioned above, a few areas in which a company structured differently from Grand



Circle will experience different issues during the process of opening a foreign office. Provided your business model, however, is similar to ours—wherein several foreign offices provide support services for the main office, but do not have sales of their own—the process we describe in this article should be of great assistance.

### ENGAGE A LOCAL PERSON

It may seem counterintuitive for lawyers to suggest hiring someone before a statutory corporate entity is set up to pay an employee, but we believe it is a critical first step. Engaging local personnel to open and operate your office will facilitate the opening of bank accounts, the finding and leasing of office space, and the hiring of other employees to manage your busi-

### **WHEN HIRING A LOCAL PERSON, YOU SHOULD PERFORM THE SAME DUE DILIGENCE YOU WOULD PERFORM IF YOU WERE HIRING A SENIOR EXECUTIVE IN YOUR MAIN OFFICE.**

ness, not to mention the finding and/or managing of local counsel. In fact, in some places, hiring local personnel first is not just advisable; it is required. In many countries, you must identify a citizen who will be the legal representative of your company before you can register your office. This requirement is particularly true in a regulated industry. In the travel industry, the requirements for tourism-service licenses almost universally include identification of a local manager with experience in the industry. Overall, the process of opening an office goes much more smoothly with competent local personnel.

When hiring a local person, you should perform the same due diligence you would perform if you were hiring a senior executive in your main office. The individual you choose will have a great deal of control over the company's operations in that country. There are, therefore, two main qualifications that this person should meet. First, you must be able to trust him/her with the company's local financial operations. Second, he/she must be familiar with the

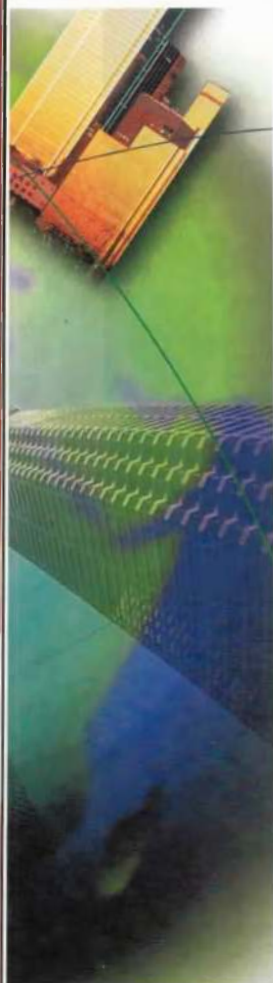
customs and practices of the industry in that country. Because we have a long history of operating internationally, albeit through third parties, we were able to use our networking contracts in most places to find qualified local personnel. From time to time, we did engage the services of an international executive recruiting firm (Heidrich & Struggles) that knows our business well and was very helpful.

You may engage the local person as a consultant, working on a project basis for the parent company. If you do so, be sure to check with labor counsel to ensure that the consulting contract is appropriate in the country in which the office will be opened. Your tax advisers may warn you that such an arrangement creates the risk of a permanent establishment of the U.S. parent company in the foreign country. (We will discuss this risk in more detail in the section dealing with formalizing the parent company-foreign office relationship.) In theory, such a risk does exist. Foreign tax authorities could determine that a portion of your parent company's profits should be deemed to have been earned in the foreign country and, thus, be subject to foreign corporate income tax and, in many cases, a value added tax ("VAT"). We believe, however, that this risk is more theoretical than real and is unlikely to materialize if you proceed from this temporary situation to the more permanent one of having an in-country statutory entity.

At this early stage, we recommend that you hire only a local general manager and, perhaps, a finance person. We believe operational staff should be hired after the entity is incorporated. If you employ operational people before you have an entity in place, you will give your office a much higher profile and thus exacerbate the risk that your parent company will be found to have a permanent establishment in the foreign country.

### RETAIN LOCAL COUNSEL

A competent local attorney can handle the registration of your foreign office, as well as general corporate matters for the entity going forward. In deciding among foreign counsel, you will want to weigh the usual qualifications of experience, skill, connections, fees, and so on.<sup>6</sup> Several other considerations that we tend not to consider when retaining counsel in the United States also come into play, however.





Unless you have foreign language skills, for example, it is important that your local attorney speak English, not just conversationally, but well enough to understand your business goals and to convey important legal concepts, preferably in writing. You will also want to ensure that his or her law firm has adequate communications, such as fax machines, voicemail and email capability, and compatible word-processing systems. We encountered one European firm, for example, whose fax machines operated only during its usual business hours, which prevented us from sending its lawyers a fax after 11 a.m. eastern standard time. We have found that email is a very convenient way to communicate with foreign counsel because it is available 24 hours a day and is usually more reliable than fax transmissions. Keep in mind, however, that the jury is still out on whether the use of email affects confidentiality and privilege. Nonetheless, we believe there is little reason to be concerned about email communications for the type of routine legal work described here.

If you are opening several offices simultaneously, the easiest way to find local counsel is to retain the services of a large international law firm with which you have worked in the past. This method will permit you to find local attorneys in many different countries with a simple phone call and possibly to negotiate alternative fee arrangements for their performance of the same work in each. While requiring the least amount of effort, this one-stop shopping with a multinational law firm has never proved to be as effective or as efficient for us as it purports to be. Most multinational firms still have inconsistent levels of quality and service in their foreign offices, and many specialize in certain types of transactions, not the routine corporate work needed in opening an office.

We have always used truly local attorneys and have emphasized hiring the lawyer, not the firm. We choose local counsel based in large part on recommendations from other in-house counsel and from local business contacts. If you focus your search on local lawyers, rather than on multinational firms, you will be more likely to find an attorney with experience in your industry.

There is a school of thought that holds that the best local lawyer to retain is one competent in general corporate and business matters, with no specific expertise. But we have found it extremely beneficial in our regulated industry to hire an attorney with

industry experience; he or she knows how to navigate the regulatory barriers to commencing operations. Local attorneys also tend to be substantially less expensive than counsel at large firms, especially outside Western Europe, because they set their fees according to the local legal market rather than the international market. With a multinational firm, you may pay the same hourly rate in Thailand that you pay in New York, while a local Thai attorney will bill at a fraction of that amount. Finally, though this is by no means true in every case, local attorneys often have much better connections within local government than "imported" attorneys, an advantage that can help you to cut through bureaucratic red tape. Finding these lawyers is always the tricky part. Our ACCA colleagues have been most helpful in advising us on whom to use and, conversely, not to use.<sup>7</sup>

When retaining foreign counsel, you need to be aware that the treatment of conflicts of interest differs around the world. Most countries do not regulate attorney conflicts the way we do in the United States, and foreign counsel may have an entirely different definition of a conflict from the one to which you are accustomed. If this concern is important for you, be sure to ask about conflicts before retaining foreign counsel. Be explicit about what you consider to be a conflict of interest, and get a confirmation in writing from counsel that no such conflict exists.

#### **PERFORM PRELIMINARY LEGAL WORK**

Once you find an attorney in the country in which you wish to establish an office, we recommend that you explain your business goals to him or her and give your initial thoughts as to which structural entity—usually a subsidiary company or branch office—best suits your needs. If you have already opened an office or are opening offices simultaneously, share with local counsel what you have done elsewhere. Then ask counsel to prepare a memorandum that analyzes the preliminary decisions that you will have to make. The memorandum should outline the ramifications of your tentative entity choice and discuss any special considerations attached to that option and any better options that may exist. It should summarize the process—in terms of timing and steps—required to set up each option, the legal mandates for each option, the tax and operational



- ACCA, "International Business Development & Expansion," *ACCA Docket* 14, no. 5 (1996): 56-57, and at [www.acca.com/protected/pubs/docket/so96/international.html](http://www.acca.com/protected/pubs/docket/so96/international.html).
- Gabe Shawn Vargas, "Coping with Global Angst: Five Practical Prescriptions" *ACCA Docket* 17, no. 4 (1999): 20-36, and at [www.acca.com/protected/pubs/docket/ja99/global-angst.html](http://www.acca.com/protected/pubs/docket/ja99/global-angst.html).
- Stuart deGeus, "A Checklist for Global Expansion," *ACCA Docket* 15, no. 6 (1997): 47-52, and at [www.acca.com/protected/pubs/docket/nd97/checklist.html](http://www.acca.com/protected/pubs/docket/nd97/checklist.html).
- The magazine *European Counsel* ran a series of articles analyzing corporate vehicles most frequently used by foreign investors. See, e.g., Machiko Kudo & Daljit Singh, "Europe's Top Business Models: The UK," *European Couns.*, Oct. 1998, at 35; Jeroen Bleeker & Jan Louis Burggraaf, "The Netherlands: The Dutch B.V.," *European Couns.*, Nov. 1998, at 15; Andreas Hunerwadel, "Switzerland: The Joint Stock Corporation," *European Couns.*, Dec. 1998/Jan. 1999, at 17; Thomas Stohlmeier, "Germany: The GmbH," *European Couns.*, Feb. 1999, at 21; Liam Brazil & Patricia Haran, "Ireland: The Limited Liability Company," *European Couns.*, Mar. 1999, at 13; Johan De Bruycker & Philippe Jadoul, "Top Corporate Vehicles: Belgium," *European Couns.*, June 1999, at 13; Jacques Buhart & Hubert Segain, "Top Corporate Vehicles: France," *European Couns.*, Sept. 1999, at 71; Cecilia Remiro Valcarcel, "Top Corporate Vehicles: Spain," *European Couns.*, Oct. 1999, at 23; Francesco Gianni, "Italy: The SpA and the Srl," *European Couns.*, Mar. 2000, at 19; Peter Radosovsky, "Czech Republic: The SRO and AS," *European Couns.*, Aug. 2000, at 23.
- Ralph H. Folsom and Michael W. Gordon, *2 International Business Transactions* 3 (1995).
- Adam Frederickson, "Agency and Distribution: Drafting Agreements That Work Across Europe," *European Couns.*, June 1997.
- Jacques Ghysbrecht, "Commissionaires: Saving Tax When Selling in Europe," *European Couns.*, Oct. 1996, at 29.
- Michael F. Zeldin and Carlo V. di Florio, "Global Risk Management Under International Anticorruption Conventions" *ACCA Docket* 18, no. 1 (2000): 18-45, and at [www.acca.com/protected/pubs/docket/jf00/global.html](http://www.acca.com/protected/pubs/docket/jf00/global.html).
- For a two-part article analyzing intragroup tax issues in various countries, see Mark Kingstone, Lynne Walkington, Neal Todd, François-Xavier Rouffiac, Rafael Vargas Moreno, & Gloria Marin Benitez, "Cross Border Dividends: Minimizing the Tax Burden," *European Couns.*, Nov. 1998, at 23; Leonardo Fedrini, Carlo Geronimo Cardia, Luc Jacobs, Fredrich E. F. Hey, & Sabine Rödel, "Cross Border Dividends: Minimizing the Tax Burden," *European Couns.*, June 1999, at 38.

implications, and the costs involved, including, of course, counsel's fees. Usually, there are filing or registration fees with a commercial registry court, initial capitalization payments (into your own account), and regular attorney's fees. In many countries, we have found counsel open to a fixed fee for this type of standard incorporation work in lieu of an hourly rate.

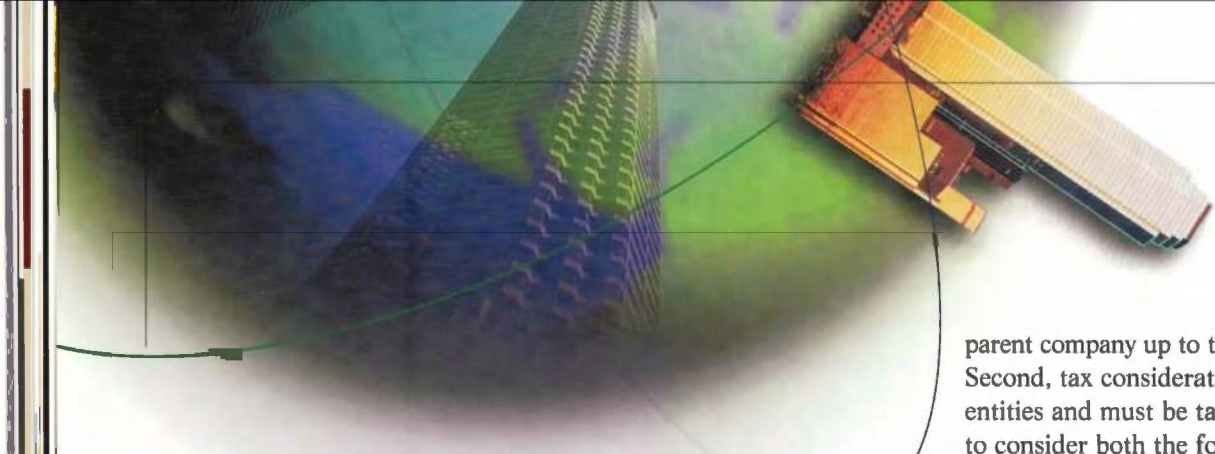
You should also ask the attorney whether there are any unique regulatory requirements with which companies within your industry must comply. As noted earlier, we have found that, in registering an entity in the regulated travel industry, we must also apply for and receive a license. This step can be a bit confusing. Some countries differentiate among licenses, depending on the area in which you participate in the industry, and there is often overlap in the operations covered. For example, we discovered that Italy has two types of licenses relevant to our business—one for a tour operator and the other for a travel agent. You must carefully analyze your operational plans to determine which license best suits your needs. You may conclude, as we did in Italy, that you need more than one.

## MAKE STRUCTURAL DECISIONS

After you have received initial advice from foreign counsel, you must decide which legal form your foreign office should take. Most countries offer only the two options of a subsidiary or a branch office. Some countries, particularly Eastern Bloc and developing countries, also offer the option of a representative office;<sup>8</sup> but because a representative office usually cannot conduct business directly, such as by entering into contracts (usually a critical element for a foreign office), your choice is realistically limited to a branch office or a subsidiary.

A branch has no independent juridical status. It exists solely as an extension of the foreign parent company. A subsidiary is incorporated under the laws of the foreign country and exists as a separate entity with independent legal status.<sup>9</sup> Your structure choice will depend on how you weigh the advantages and disadvantages of each option and, of course, on tax consequences. Although we touch upon some of the post-office-setup tax issues in this article, such as intercompany service agreements, we do not discuss dividends and profit repatriation.<sup>10</sup>





**CHANGING THE STRUCTURE OF AN OFFICE OR THE IDENTITY OF MANAGERS AND DIRECTORS IS ALWAYS TWICE AS MUCH WORK WITH A BRANCH OFFICE THAN IT IS WITH A SUBSIDIARY COMPANY.**

You may find that the branch-versus-subsi- diary decision is out of your hands. The nature of the busi- ness you are in or the country in which you are establishing an office may dictate the type of presence you choose. By requiring foreign companies to form a local corporation rather than to open a branch office, a government can ensure that the entity complies with its corporation laws.<sup>11</sup>

Our own company's need to acquire a license to provide tourism services had a major effect on our decision. In some countries, a branch of a foreign cor- poration cannot receive a license, so in those countries, we had to form a subsidiary company. In other countries, a branch can receive its own license. Our company's Dutch subsidiary has a branch in Greece that is licensed to provide tourism services in Greece and a branch in Turkey that is licensed to pro- vide tourism services in Turkey. In European Union ("EU") countries, where the free movement of goods and services is encouraged, a branch can provide tourism services if its parent company is domiciled and licensed in another EU country. So, for example, our Spanish subsidiary, which is licensed in Spain, could open a branch in Italy without having to apply for a license in Italy.

Of course, your choice of entity must be able to meet the operational needs of your business. Assuming the country imposes no restrictions, you should keep in mind two important considerations. First, subsidiaries provide the parent company more protection from liability than branches do. The parent company is wholly responsible for the debts and lia- bilities of the branch office, which is simply an extension of the parent. The assets of the parent com- pany can be reached to satisfy obligations of the branch. If a subsidiary is used, however, the tradi- tional form of corporate limited liability protects the

parent company up to the shareholders' capital. Second, tax considerations differ between the two entities and must be taken into account. You need to consider both the foreign country's and the U.S. taxation schemes.<sup>12</sup>

We have found a subsidiary company preferable to a branch office, primarily for administrative reasons. Changing the structure of an office or the identity of managers and directors is always twice as much work with a branch office than it is with a subsidiary com- pany; you have to create two sets of corporate documents—one for the parent company and one for the branch office—every time a change occurs. When we decided, for example, to change the legal repre- sentative of the Paris branch of our Dutch company, we had to draft a resolution in the Netherlands, appoint the new representative to the board of the Dutch company, and only then file the necessary paperwork in France. This process created a triangle of paperwork among Paris, Amsterdam, and Boston and involved two foreign law firms instead of just one. Legal bills were higher, and the process was much more time-consuming.<sup>13</sup>

If you decide to form a subsidiary, most countries offer a standard corporation form similar to a C- Corp, with traditional corporate tax treatment and limited liability for shareholders. In France, for exam- ple, you can form an SA (*Société Anonyme*); in Germany, an AG (*Aktiengesellschaft*). Because this traditional corporate form offers the opportunity to trade shares on public stock exchanges, its formation and maintenance entail substantial procedural and substantive requirements designed to protect investors among the general public.

All of the subsidiary companies that we set up have a limited number of shareholders. Most of our sub- sidiaries have only one shareholder, either the U.S. parent company or our Dutch holding company. In such a situation, many countries offer a corporate form analogous to the limited liability company ("L.L.C.") in the United States.<sup>14</sup> France offers the SARL (*Société à Responsabilité Limitée*), for example, and Germany, the GmbH (*Gesellschaft mit beschränk- ter Haftung*).<sup>15</sup> These forms can be ideal for subsidiary companies. The procedural requirements are much less burdensome because they are not intended for public ownership. They tend to be relatively easy to set up and have less restrictive meeting and reporting requirements than their full-blown corporate counter-



parts. The tradeoff, of course, is that they usually cannot be traded publicly and, in some cases, cannot issue shares.<sup>16</sup> Because we were interested primarily in ease of establishment and maintenance and had no intention of taking our subsidiaries public, we chose this corporate form whenever possible.<sup>17</sup>

## DETERMINE OFFICE GOVERNANCE

By this time, you have hired a local general manager and perhaps a finance person to manage the business, retained local counsel, and decided what legal form your new office should assume. Next, local counsel should handle concurrently the commercial and tax registration of your branch or subsidiary and the application for a license, if one is required. Ask your local counsel to provide a detailed timeline for each of these processes, including a description of the steps, the required documentation, and the anticipated costs, such as attorneys' fees, taxes, and filing/licensing fees.

This stage in the process is also the time for you to decide who will have signatory power for the office. For all of the day-to-day operations, local people on the ground should be able to act on behalf of the company, whether as directors of the subsidiary or through powers of attorney for routine business transactions, such as maintaining bank accounts, paying vendors and employees, and entering into contracts. Extraordinary events, such as the purchase or sale of a business, and major financial commitments, such as a lease obligation, should require home-office approval.

Get together with your colleagues in the finance department to identify the boundaries between your company and its new office. There is always a balance of interests. On the one hand, your parent company will want to maintain control over the subsidiary, an interest that weighs in favor of keeping major decision-making power within headquarters. On the other hand, your parent may find it to be an administrative nuisance to send documents constantly back and forth across continents for negotiation and signing, an interest that weighs in favor of granting greater leeway to subsidiary personnel. One way to satisfy both interests is to grant substantial power to local personnel, while implementing sufficient internal controls to minimize the inherent risk in delegating authority.

If you are forming a subsidiary, you will need to determine who the shareholders of the company should be. Local law may restrict your options. Our experience suggests that subsidiaries are easiest to maintain when they have only one shareholder: the foreign parent company or an intermediary foreign holding company. Corporations frequently establish a foreign holding company in the Netherlands because Dutch corporate law provides a fair amount of flexibility and favorable dividend withholding-tax treatment. Depending on how your enterprise is structured, this option may not be initially possible. We ran into problems in Poland, for example. We wanted our Polish subsidiary to be wholly owned by our Dutch subsidiary, which is itself wholly owned by our U.S. parent company, but Polish law prohibits the registration of a sole-shareholder corporation when that sole shareholder is itself a corporation with only one shareholder. Therefore, our Dutch subsidiary is a majority shareholder in the Polish subsidiary, and the American parent is a minority shareholder.

Thailand also presented a challenge. Thai law requires our subsidiary to have at least seven shareholders. If at least four of those shareholders are Thai, the law will treat the company as a domestic Thai corporation, a status that carries many benefits. Pursuant to a treaty between Thailand and the United States, American shareholders are to be treated the same as Thai shareholders. Our company therefore needed seven shareholders, four of whom had to be Thai or American. Unfortunately, our company did not have four U.S. entities it could use as shareholders, so we were forced to use natural persons as shareholders—thereby complicating their personal income tax situations. The lesson here is that you should be prepared to use multiple shareholders, because one may not be enough.

You should also put some thought into selecting the officers and directors of the entity. Here, again, local law may restrict your choices. For example, in some countries, directors are required to be shareholders, as well. In addition, some countries, like Switzerland, may require you to appoint a local national as an officer or director. Appointing a local national is generally wise even in the absence of a requirement because you will need at least one local person with signatory power to handle day-to-day operational concerns of the office. If your local general manager does not qualify, outside counsel are



## SAMPLE LETTER OF INDEMNITY

(Date)

(Name)

(Address)

RE: Letter of Indemnity

Dear (Name):

Our policy at Grand Circle, L.L.C., is to indemnify all associates of Grand Circle when they assist us by serving as a legal officer or director of any of our affiliated companies and to provide them the maximum possible protection permitted by law.

This Letter hereby grants you indemnification in the event that you are or may become a party to any threatened, pending or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative, arising from any action you take at the request of or on behalf of Grand Circle in your capacity as a director or an officer. In addition, Grand Circle will indemnify you for any obligations you undertake at the request of or on behalf of Grand Circle.

You will be indemnified against expenses (including legal fees), judgments, fines, and amounts paid in settlement that you actually and reasonably incur, provided that you acted in good faith and that you reasonably believed your actions were in the best interests of the Company and that, with respect to any criminal proceeding, you had no cause to believe your conduct was unlawful. Grand Circle will not indemnify you in the event that you act in bad faith or in a manner you know or should know is not in the best interests of Grand Circle.

Please sign both copies of this Letter to acknowledge receipt, keep one copy for yourself, and return the other copy to the Legal Department.

Sincerely,

\_\_\_\_\_  
(Chairman) (Name)  
Chairman & CEO  
Grand Circle L.L.C.

usually willing to perform this duty for a fee as long as you provide the requisite indemnification.

At the risk of pointing out the obvious, it is also important to appoint several directors. Imagine your frustration if you discover in the face of a deadline for signing a corporate document that the only local director is on vacation. We have started to adhere to a uniform formula for appointing directors of our foreign subsidiaries. We name the local general manager as a director and also appoint three or four senior executives in our Boston office. Because most of the subsidiary corporate governance documents come through our legal department in Boston, it is easiest to have the documents signed by directors located there.

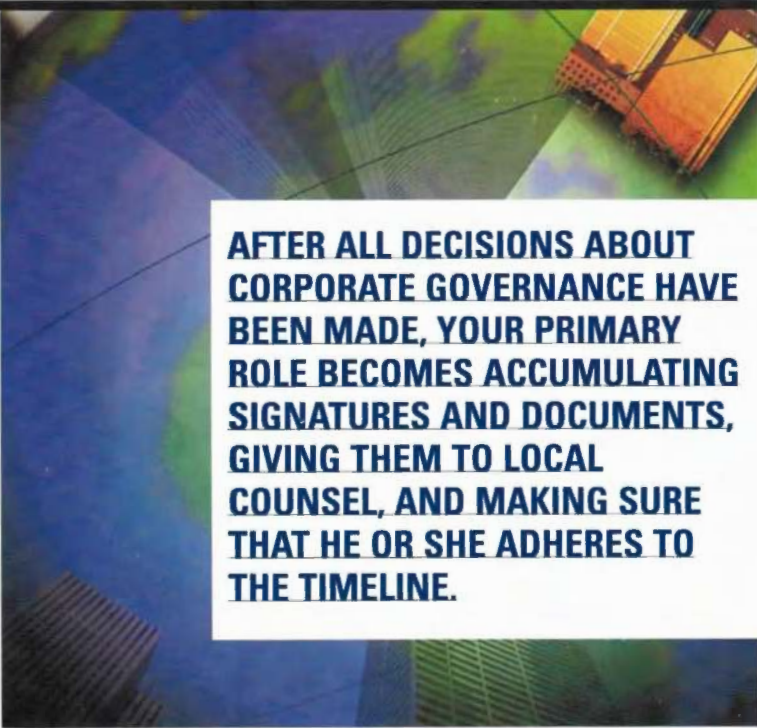
You can define directors' signatory powers in the subsidiary's articles of incorporation. The directors located in our Boston office have unlimited signatory power for the subsidiary companies; one such director can sign any necessary corporate documents. As discussed above, we usually restrict the signatory powers of our local office managers. This restriction is not possible, however, in countries that require companies to appoint a local person as their legal representative. Such a position usually vests in this individual unlimited power to make decisions for the company, but at the risk of personal liability for corporate actions.

We recommend that you provide indemnification for your directors and officers. Many of our local managers have expressed a concern about this issue because, in many places, they assume significant personal liability by acting on behalf of the company. Most foreign countries do not permit corporations to provide in their articles of incorporation and bylaws for such indemnification, as they can in the United States. You must specify this coverage in a separate document. To protect our employees who have signatory power, we give each a letter of indemnity (see sidebar). The letter states that the company will indemnify the employee for all actions taken in the course of employment, except for those performed in bad faith.

Although your local counsel will give you a specific list of the documents required to register the office, you should expect to produce the following: incorporation documents of the parent company; copies of passports and personal information (name, address, date and place of birth, and identification or Social Security number) for all officers and directors;



shareholder resolutions for the parent company that authorize the establishment of the foreign office; proof that the directors have no criminal record and have not been involved in a bankruptcy; and powers of attorney that allow the local counsel and office manager to act on the parent's behalf in registering the company. If your industry is regulated and you need to apply for a license, you may have to provide copies of the office lease and proof that your local employees are experienced in the industry and that you have adequate insurance coverage.



**AFTER ALL DECISIONS ABOUT CORPORATE GOVERNANCE HAVE BEEN MADE, YOUR PRIMARY ROLE BECOMES ACCUMULATING SIGNATURES AND DOCUMENTS, GIVING THEM TO LOCAL COUNSEL, AND MAKING SURE THAT HE OR SHE ADHERES TO THE TIMELINE.**

Many countries also require initial capitalization, ranging from a few thousand dollars to tens of thousands of dollars. In regulated industries, the initial capitalization requirements may be substantially higher. To receive some of our licenses, we also had to meet other financial thresholds. In Greece, for example, we had to provide a letter of credit in favor of the tourism board for \$10,000; in Portugal, we had to pay a license tax of \$13,000; and in Italy, we had to present a letter from our bank attesting to our creditworthiness for up to \$200,000.

In the United States, it is quite simple to prepare and file corporate formation documents. Many states offer corporate forms on the internet; some states, such as Delaware, even allow forms to be filled out

and filed over the internet. Corporate counsel accustomed to preparing corporate documents in the United States may suffer a bit of culture shock when registering a foreign subsidiary. Most countries require the corporate formation documents to be signed by all directors and signed and sealed by a notary. We once had foreign counsel tell us that all directors had to sign the documents at the Italian consulate, in front of a notary licensed in Italy. This requirement raised the frightening specter of informing four members of our company's senior executive team that they had to spend an afternoon at the Italian consulate, waiting to sign a simple corporation registration form. Fortunately, such extreme measures are seldom necessary, and it turned out that we did not have to deliver directors to the Italian consulate in order to register our Italian company.

The Hague Convention, of which the United States is a member, provides that documents notarized in the jurisdiction in which the document was executed and certified by an official in that jurisdiction are given full legal recognition in another country that is also a member of the Convention.<sup>18</sup> The relevant official certifies the document by attaching an "apostille," which is simply a piece of paper affirming the notarization.<sup>19</sup>

After all decisions about corporate governance have been made, your primary role becomes accumulating signatures and documents, giving them to local counsel, and making sure that he or she adheres to the timeline. Counsel should then register the branch or subsidiary, complete the tax registration, and ensure that you are in compliance with all necessary regulatory requirements for your industry. The time to complete this process varies greatly from country to country and can take anywhere from two weeks to several months, depending on the nature of the bureaucracy in the particular country. After registration is complete, ask local counsel to give you a calendar of future filing requirements and deadlines. Find out what corporate filings must be prepared, when tax filings are due, and what, if any, ongoing regulatory requirements apply to your industry.

#### **FORMALIZE THE PARENT-FOREIGN OFFICE RELATIONSHIP**

The last step in creating a foreign office involves formalizing the relationship between the office and your parent company. You will need to decide



whether you would like the Internal Revenue Service ("IRS") to treat the foreign subsidiary as a subsidiary or as a branch office for U.S. tax purposes. The IRS has a procedure in which a parent company can elect to treat a foreign subsidiary as a branch office. The primary benefit of "checking the box," as this procedure is known, is the avoidance of double taxation of subsidiary income—income taxed once to the subsidiary when it is earned and taxed again when distributed to the parent company as a dividend. In service companies like ours, in which foreign subsidiaries show a small profit through transfer pricing in order to comply with foreign tax regulations, "checking the box" is strongly recommended. You receive the most flexibility if you file the appropriate tax form (Form 8832) with the IRS within 75 days of the subsidiary's date of incorporation. If you meet this deadline, not only is the pass-through tax treatment effective as of the date of the incorporation, but also you can revert back to subsidiary tax treatment at any time. If you file the form after 75 days, you cannot revert back to subsidiary treatment until five years after you have checked the box, unless you request and receive approval from the IRS commissioner.

You will also want to implement an intercompany service agreement to govern the relationship between your parent company and the subsidiary. Our main goal in using service agreements is to minimize the likelihood that foreign tax authorities will consider the foreign office to be a permanent establishment of the parent company. If our U.S. parent were deemed to have a permanent establishment in France, for example, then it would be subject to French corporate income tax on all income earned on sales of tours to France. We make all of our sales in the United States to American consumers, so the income is reported as earned in the United States and subject to taxation here.

Permanent establishment can be a tricky issue, especially because many countries do not define it affirmatively in their tax codes. Instead, they may speak of permanent establishment in the negative with a statement that begins, for example: "A company shall not be deemed to have a permanent establishment solely because . . ." Significant questions that determine whether a company has a permanent establishment in a foreign country include how the parent exercises control over the subsidiary company, who has the power to sign for the parent company, and where company representatives sign

contracts. To discourage a permanent establishment, the parent and subsidiary must maintain an arms-length relationship.<sup>20</sup>

One of the best ways to demonstrate an arms-length relationship is to ensure that the new subsidiary has some profit. The intercompany service agreement can provide for this profit by requiring that the parent company's funding of the foreign office be on a "cost-plus" basis. Usually some percentage between 5 and 10 percent is appropriate, but this amount can vary. You should consult tax counsel for more detailed advice based on your overall tax strategy and planning. Different countries may consider different profit percentages to be acceptable; a truly "safe" enterprise would calculate each subsidiary's profit level based on the preferences of that country's tax authorities. A company that is less risk-averse may choose a uniformly low profit percentage. The fact that the profit percentage is the same in all countries in which your parent company has subsidiaries can be a strong argument in your favor should the tax authorities in one country challenge your position.

## CONCLUSION

Every country has its own laws governing the formation and governance of statutory corporate entities. Civil law and common law countries differ; Third World countries differ from industrialized countries; and communist (and formerly communist) countries differ from historically free-market countries, either in terms of the substantive legal provisions or the legal processes involved. The remarkable truth inherent in setting up foreign legal entities is not how radically the legal systems differ in the various countries, but rather how, in the face of such differences, a uniform plan applies in almost every country.

The great advantage of the uniform plan we outline in this article is its ease of application for someone with little or no international experience. Many companies going global have had much less international exposure than Grand Circle has had. Our goal in writing this article was to provide a primer for the novice seeking a framework for opening offices internationally; and if you follow the six steps we outline by engaging a local person, retaining local counsel, performing preliminary legal work, making structural decisions, determining office governance, and then formalizing the relationship



between the office and the parent company, you will be able to open an office virtually anywhere in the world. ☐

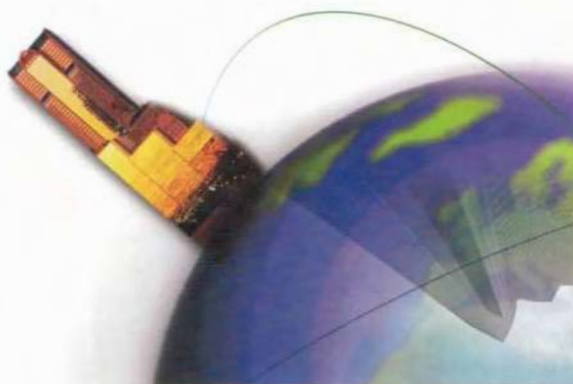
#### NOTES

1. Grand Circle has offices in the Netherlands, the United Kingdom, France, Germany, Switzerland, Italy, Spain, Portugal, Poland, Croatia, Greece, Turkey, Egypt, South Africa, Australia, Thailand, Hong Kong, and China.
2. See Adam Frederickson, *Agency and Distribution: Drafting Agreements That Work Across Europe*, EUROPEAN COUNS., June 1997, at 17.

3. Sales offices that generate substantial income give rise to different structuring needs; for example, counsel must take into account repatriating profit in a tax-efficient manner. Counsel representing U.S. companies that are manufacturing in foreign countries need to research available governmental incentives and subsidies for bringing jobs to the location. Exit strategies for these types of organizations are also critical, but beyond the scope of this article.
4. See Frederickson, *supra* note 2.
5. See Stuart deGeus, *A Checklist for Global Expansion*, 15 ACCA DOCKET 6, pp. 47-52. DeGeus describes the lessons learned by Domino's Pizza when it took its franchise concept worldwide by selling developmental rights in foreign countries to local partners.
6. See ACCA, *International Business Development & Expansion*, 14 ACCA DOCKET 5, pp. 56-57.
7. ACCA Online<sup>SM</sup> provides the excellent MemberToMember<sup>SM</sup> service for exactly this type of networking. See [www.acca.com](http://www.acca.com).
8. Representative offices exist primarily in communist, or formerly communist, countries, such as Russia and China. Companies use them to establish a presence from which to consider the commercial opportunities available, develop a business plan, study the market, and so on.
9. Ralph H. Folsom and Michael W. Gordon, 2 INTERNATIONAL BUSINESS TRANSACTIONS 3 (1995).
10. Dividends will always be subject to a withholding tax that varies from country to country and therefore should be minimized so as to reduce net exposures. Profit repatriation is a whole other story. Where true profits are generated locally (unlike this service model we've explained), an intermediate holding company in a favorable tax jurisdiction is often used. Again, such a structure would require extensive advice from international tax experts.
11. *Id.* at 5.
12. For a two-part article analyzing intragroup tax issues in various countries, see Mark Kingstone, Lynne Walkington, Neal Todd, François-Xavier Rouffiac, Rafael Vargas Moreno, & Gloria Marin Benitez, *Cross Border Dividends: Minimizing the Tax Burden*, EUROPEAN COUNS., Nov. 1998, at 23; Leonardo Fedrini, Carlo Geronimo Cardia, Luc Jacobs, Fredrich E. F. Hey, & Sabine Rödel, *CROSS BORDER DIVIDENDS: MINIMIZING THE TAX BURDEN*, EUROPEAN COUNS., June 1999, at 38.
13. The choice of a subsidiary also provides for a less cumbersome exit strategy. If you decide to spin off one country's business, close a foreign office, or refinance the office, you can do so more easily if that country's business constitutes a distinct corporate legal entity.
14. See Nicholas G. Karambelas, *New Lease on Life for Limited Liability Companies*, THE WASH. LAWYER, Sept. 2000, at 31, for a discussion of the attributes of a limited liability company.
15. Note, however, that, although the L.L.C. offers pass-through tax treatment similar to that given a partnership, most foreign counterparts are taxed as corporations.



16. The Italian Srl (*società a responsabilità limitata*), for example, has no shares.
17. The magazine *European Counsel* ran a series of articles, beginning in 1998, that analyzed the corporate vehicles most frequently used by foreign investors. See, e.g., Machiko Kudo & Daljit Singh, *Europe's Top Business Models: The UK*, EUROPEAN COUNS., Oct. 1998, at 35; Jeroen Bleeker & Jan Louis Burggraaf, *The Netherlands: The Dutch B.V.*, EUROPEAN COUNS., Nov. 1998, at 15; Andreas Hunerwadel, *Switzerland: The Joint Stock Corporation*, EUROPEAN COUNS., Dec. 1998/Jan. 1999, at 17; Thomas Stohlmeier, *Germany: The GmbH*, EUROPEAN COUNS., Feb. 1999, at 21; Liam Brazil & Patricia Haran, *Ireland: The Limited Liability Company*, EUROPEAN COUNS., Mar. 1999, at 13; Johan De Bruycker & Philippe Jadoul, *Top Corporate Vehicles: Belgium*, EUROPEAN COUNS., June 1999, at 13; Jacques Buhart & Hubert Segain, *Top Corporate Vehicles: France*, EUROPEAN COUNS., Sept. 1999, at 71; Cecilia Remiro Valcarcel, *Top Corporate Vehicles: Spain*, EUROPEAN COUNS., Oct. 1999, at 23; Francesco Gianni, *Italy: The SpA and the Srl*, EUROPEAN COUNS., Mar. 2000, at 19; Peter Radosovsky, *Czech Republic: The SRO and AS*, EUROPEAN COUNS., Aug. 2000, at 23.
18. An apostille can be provided by the office of the Secretary of State for the state in which the document was notarized; we receive, for example, our apostilles from the office of the Secretary of the Commonwealth of Massachusetts.
19. See [www.state.gov/www/authenticate/list.html](http://www.state.gov/www/authenticate/list.html) (last visited Nov. 15, 2000) for a list of member nations of the Hague Convention.
20. See Jacques Ghysbrecht, *Saving Tax When Selling in Europe*, EUROPEAN COUNS., Oct. 1996, at 29.



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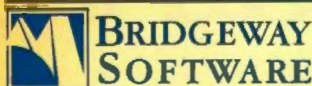
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