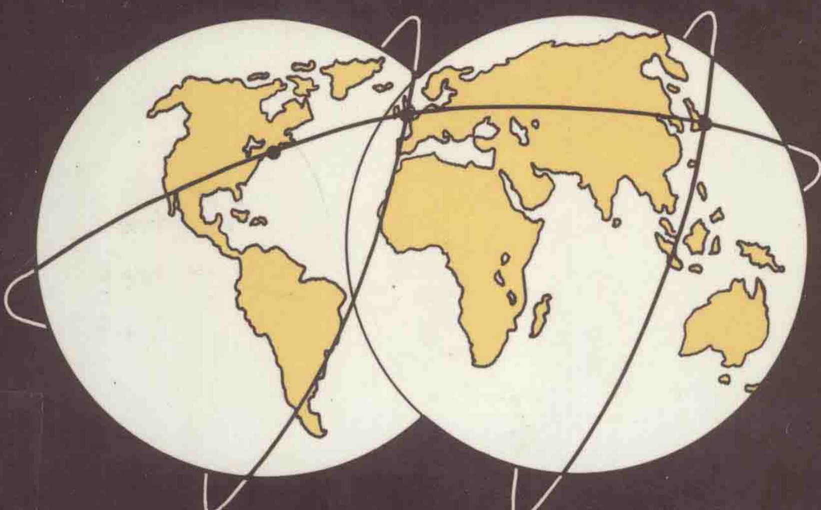
John I. Forry
Mark R. Joelson

JOINT VENTURES in the UNITED STATES



Butterworths

Joint Ventures in the United States

Edited by
John I. Forry
Mark R. Joelson

London
Butterworths
1988

United Kingdom	Butterworth & Co (Publishers) Ltd, 88 Kingsway, LONDON WC2B 6AB and 61A North Castle Street, EDINBURGH EH2 3LJ
Australia	Butterworths Pty Ltd, SYDNEY, MELBOURNE, BRISBANE, ADELAIDE, PERTH, CANBERRA and HOBART
Canada	Butterworths Canada Ltd, TORONTO and VANCOUVER
Ireland	Butterworth (Ireland) Ltd, DUBLIN
Malaysia	Malayan Law Journal Sdn Bhd, KUALA LUMPUR
New Zealand	Butterworths of New Zealand Ltd, WELLINGTON and AUCKLAND
Singapore	Butterworth & Co (Asia) Pte Ltd, SINGAPORE
USA	Butterworths Legal Publishers, ST PAUL, Minnesota, SEATTLE, Washington, BOSTON, Massachusetts, AUSTIN, Texas and D & S Publishers, CLEARWATER, Florida

A CIP Catalogue record for this book is available from the British Library.

ISBN 0 406 49961 6

Typeset by Phoenix Photosetting, Chatham, Kent
Printed and bound in Great Britain by
Mackays of Chatham PLC, Chatham, Kent

Preface

A foreign corporation or other investor often may wish to establish a US business enterprise in order to increase its access to the US market and free enterprise system, or to reduce its concern that exports to the United States may be priced out of the US market by the increased value of foreign currencies or excluded by US trade barriers. In such a case, the foreign investor may decide to establish the US business enterprise in conjunction with another investor – usually a US corporation or other US business – for a number of reasons.

The foreign investor may feel the need to associate with others who know the US market and business methods. While such expertise may be acquired by hiring experienced executives, an existing US enterprise also may have well established marketing ties with potential customers, and may have manufacturing and/or service facilities immediately available. Such a joint arrangement also may spread the risk for the new investor, and may provide an additional source of financing for the US enterprise. When experienced individuals are hired, it may also be necessary to offer them at least a small joint equity participation in the enterprise in order to attract highly qualified executives.

The structure of such a joint arrangement will depend on the nature of the enterprise to be undertaken. A partnership or other unincorporated joint venture may be formed for the purpose of carrying out a single undertaking, or a series of undertakings of relatively short duration. Where the operation of an ongoing business is contemplated, the parties usually will form either a partnership or a jointly owned corporation. The choice between an unincorporated and incorporated joint venture often will turn on such considerations as limitation of liability, management arrangements, and tax planning.

This book addresses many of the legal, tax, and related considerations that must be considered by a foreign investor in establishing and operating a US joint venture. The focus here is on enterprises in which a foreign investor has a substantial – usually 10% or more – interest, rather than on widely owned investment funds or similar vehicles in which a foreign investor holds only a portfolio investment.

The book is structured as a series of essays by experienced legal and tax advisers on a variety of key issues and types of US joint ventures. After discussing alternatives to joint ventures, the authors describe the basic forms and terms of US joint ventures. Special issues of research and development joint ventures, and of real estate and natural resource ventures, are then addressed. Subsequent chapters describe US antitrust restrictions, US tax aspects, and use of lease financing for US joint ventures. Personnel transfers in light of US visa restrictions are also outlined. The final chapter examines US reporting requirements for foreign investments in US joint ventures. The text reflects major developments through approximately the end of 1987.

The appendices include copies of the model uniform acts which govern the organization and operation of general and limited partnerships in almost all US states, and copies of forms for initial reports to the US federal government usually required upon formation of a US joint venture involving a foreign investor.

This book contains vital information for corporate executives and investors outside the United States who are contemplating US joint ventures in distribution or manufacturing, research and development, real estate, or other areas. It is also valuable for US corporations or other investors who are contemplating entering such ventures with foreign investors.

JOHN I. FORRY
MARK R. JOELSON

May 1988

List of Contributors

Author and Editor

John I. Forry Los Angeles, California. Partner in Morgan, Lewis & Bockius. Member of the Bars of California, the US Tax Court, and the US Supreme Court. AB, Amherst College; JD, Harvard University. Recent publications: *A Practical Guide to Foreign Investment in the United States* (BNA International Inc, 2nd edn, 1982; French edn, 1980; Japanese edn, 1983; German edn, 1983) (author and editor); *Differences in Tax Treatment of Foreign Investors: Domestic Branches and Domestic Subsidiaries* (Kluwer Law and Taxation Publishers, 1984) (general reporter and editor); 'The Impact of the US Tax Reform Act of 1986 on International Transactions', *Private Investors Abroad*, ch 6 (Matthew Bender & Company Inc, 1987) (co-author). Recent activities: Member, Advisory Group to the US Commissioner of Internal Revenue, 1985–1986; Chairman, Committee on US Activities of Foreigners and Tax Treaties, American Bar Association Section of Taxation, 1979–1981; Chairman, International Law Section, 1978–1979, and Chairman, Foreign Tax Law Committee, 1974–1976, Los Angeles County Bar Association; Adjunct Professor of Law, Southwestern University, 1973–1979; Instructor in International Taxation, University of Southern California, 1976–1980. Member: American, International, and Los Angeles County Bar Associations; International Fiscal Association.

Editor

Mark R. Joelson Washington, DC. Partner in Morgan, Lewis & Bockius. Member of the Bars of the District of Columbia, the Court of International Trade, and the US Supreme Court. AB, Harvard College; JD, Harvard Law School. Recent publications: *Enterprise Law of the 80s* (American Bar Association, 1980) (co-editor); *Current Legal Aspects of Doing Business in the European Economic Community* (American Bar Association, 1978) (co-editor). Recent activities: American Bar Association Representative to the International Bar Association Council, 1984– ; Chairman, American Bar

Association Section of International Law and Practice, 1983–1984; Adjunct Professor in Law, Georgetown University Law Center (international licensing), 1980–1982; Professorial Lecturer in Law, George Washington University (antitrust law), 1980–1981. Member: Department of State Advisory Committee on International Investment, Technology and Development, 1978–1987; Member: American, International, and Federal Bar Associations.

Authors

Iain C. Ballie London, England. Senior European Partner in Ladas & Parry. Member of the Bars of New York, US Court of Appeals for the Federal Circuit, and the US Supreme Court. Registered US Patent Attorney, UK Chartered Patent Agent, European Patent Attorney. BSc, Glasgow University, Scotland; JD, Fordham University. Recent publications: *Practical Management of Intellectual Property* (Longman Group, 1st edn, 1986); *Licensing – A Practical Guide for the Businessman* (Longman Group, 1st edn, 1987); 'Franchising: Trade Mark Practitioners' Perspective', *International Franchising – An Overview,* ch 3 (Elsvier Science Publishers, 1984); 'The Law and Management of New Ideas', *Int J Technology Management*, Vol 3, No 3, pp 273–283; 'Franchising in the International Regime of Intellectual Property', *The Journal of International Franchising and Distribution Law*, Vol 2, No 2, pp 57–108, 1987; and numerous other publications in professional and business journals. Member: American Bar Association, American Intellectual Property Law Association, Fellow, Chartered Institute of Patents Agents (UK), Fellow, Institute of Trade Mark Agents (UK) and numerous other professional groups.

Robert D. Comfort Philadelphia, Pennsylvania. Partner in Morgan, Lewis & Bockius. Member of the Bars of Pennsylvania, the US Tax Court and the US Supreme Court. AB, Princeton University; JD, Harvard Law School. Law clerk to Hon Lewis F. Powell, Jr, US Supreme Court, and to Hon James Hunter III, US Court of Appeals for the Third Circuit. Recent activities: Lecturer on Advanced Corporate Tax Problems, University of Pennsylvania Law School. Member: American and Philadelphia Bar Associations.

Richard D. Fraade Beverly Hills, California. Member of the Bar of California. BA, University of California; JD, Brooklyn Law School.

Joseph H. Hennessy Philadelphia, Pennsylvania. Partner in Morgan, Lewis & Bockius. Member of the Bars of Pennsylvania, Washington, and the US Supreme Court. AB, LaSalle College; MA and PhD, University of Notre

Dame; JD, Temple University. Member: American, International, and Philadelphia Bar Associations.

Dieter G. Lange London, England. European Partner in Wilmer, Cutler & Pickering. Member of the German and EC Bars. JD, University of Bonn, West Germany. Recent publications: *Civil Litigation in the United States: A Practical Guide for German Companies* (English edn, 1985; German edn, Verlag Recht and Wirtschaft, 1987) (co-author with Stephen Black); *The Extraterritorial Application of National Laws* (Kluwer, 1987) (co-author and co-editor with Gary Born); 'Der Justizkonflikt zwischen den USA und Europa dargestellt am Beispiel des Falles "Laker"', *der Justizkonflikt zwischen den USA und Europa*, (Gieseking Verlag, 1988). Recent activities: Chairman of the International Chamber of Commerce's Committee on Extraterritorial Application of National Laws, 1984–1987; Chairman of the Symposium 'Resolving Extraterrritoriality Conflicts in an Interdependent World Economy', 1988, Arbitrator in International Chamber of Commerce Arbitration. Member: German Bar Association, German-British Lawyers Association, German American Lawyers Association, American Society of International Law, International Bar Association.

Thomas J. Vallone Philadelphia, Pennsylvania. Associate in Morgan, Lewis & Bockius. Member of the Bar of Pennsylvania. BA, Rutgers University; JD, Harvard Law School. Member: American and Philadelphia Bar Associations.

Contents

CHAPTER I

Evaluating Alternatives to US Joint Ventures

John I. Forry

INTRODUCTION

This chapter discusses key alternatives to US joint ventures which may be considered by a foreign investor before entering into a joint venture involving US products, services, research and development, or US real estate or other natural resources investments. Each such alternative may provide advantages or involve limitations which are especially relevant to a particular investor's situation, and so each should be examined at least briefly by an investor contemplating a US joint venture.

ALTERNATIVES FOR US PRODUCTS, SERVICES, OR RESEARCH AND DEVELOPMENT ACTIVITIES

Licensing or franchising

One key alternative for exploiting the US market in products, services, or research and development is to license or franchise unrelated parties to use in the United States the foreign investor's technology or other intellectual property in the form of, eg, patents, knowhow, trademarks, or tradenames for particular products or services. Indeed, a joint venture itself may license from a foreign venturer the use of technology or other intellectual property, and this may involve legal and/or tax issues for the foreign venturer as discussed in subsequent chapters here.[1] In the first instance, however, what are the general advantages and limitations of a licensing or similar arrangement as an *alternative* to a joint venture or other form of US activity?

Advantages

Generally little or no capital investment in the United States is required from a licensor, and often few or no permanent staff personnel will need to be

1 See chs III and VI infra.

maintained in the United States by the licensor. Licensing also may be feasible where US importation of goods is not – eg, if licensed products are too heavy or bulky to make shipping them over long distance competitive, or where tariff or non-tariff barriers limit imports into the United States. Moreover, it may be possible to obtain access to improvements developed at the US licensee's expense – or even a minority equity position in the US licensee – in exchange for the licensing of the technology or other intellectual property.

It may also be possible to avoid substantial US income taxes on license royalties by careful use of US income tax treaties. Further discussion of license arrangements appears in the subsequent chapters covering taxation of US joint ventures and use of intellectual property by the venture. Particular care should be taken, however, to avoid the tax pitfalls in simply *sublicensing* by a treaty protected entity to the US licensee technology or other intellectual property owned by a *non*-treaty protected licensor. Planning is also needed to meet the increasing US limits on the use of a tax treaty by corporations or other entities of the treaty country which are owned by *nonresidents* of that country.[2]

Limitations

Certain potential limitations on the utility of licensing should be noted. First, substantial efforts may be required to locate a suitable US licensee. If the foreign owner chooses a licensee which lacks sufficient experience, skill, or capital to exploit the licensed technology or other intellectual property, or which tries later to exploit the same in an unauthorized manner, several years of delay may occur before the license can be terminated. Similarly, initial US franchising of a complex operation often will require the more extensive business involvement and control by the foreign franchisor that can be provided by a joint venture arrangement.

Second, there are significant US antitrust limitations on a licensor's liability to control the pricing of products or services, territorial allocations, and other matters involving the licensee's activities. The licensor's access to improvements by the licensee must be carefully negotiated, and in the United States such so called grantback clauses may be more sustainable if made non-exclusive.[3] In the case of US franchises, issuance or termination may be governed by US federal and/or state franchise and business opportunity laws as well.[4]

Third, the foreign licensor may have significant responsibilities with respect to US activities. In the case of a trademark license, the agreement must include quality control over US products and services by the licensor, and enforcement

2 See chs III, VI infra.

3 For more information on such antitrust and other limitations on license clauses, see J. Forry, *A Practical Guide to Foreign Investment in the United States* (2nd edn, 1982) ch IV.

4 See, eg K. Slade, 'Applicability of Franchise and Business Opportunity Laws to Distribution and Licensing Agreements,' (1987) 15 AIPLA QJ 1.

of the licensee's obligation to engage in actual US use of the mark. Moreover, non-disclosure obligations as to licensed knowhow by the licensee or its employees may be drafted into the license agreement, but may be difficult to inspect and enforce from abroad. The licensor also must specify the equipment and/or knowhow which is to be returned to the licensor upon termination of the license, and the trademark or other rights which then revert to the licensor, and must be prepared to take steps to enforce such provisions.

There are at least two further basic limitations on the utility of licensing. First, the US manufacturing and marketing expertise in the licensed product or service is largely developed over time in the licensee, *not* the licensor. Second, the licensor – except in fairly limited cases – often must settle for a rather modest percentage of the total profits to be obtained from the US exploitation of its technology or other intellectual property.

Importing and distribution

A second key alternative to using a US joint venture is to limit the foreign investor's US activities to importing and/or distribution of foreign products.

Advantages

One advantage of such an approach is that little capital investment or permanent staff in the United States often are required by an importer. Moreover, US income taxation of the importer may be minimal *if* it has no US business operations or, under a US income tax treaty, has no US permanent establishment, as noted in the subsequent chapter dealing with the general tax aspects of US joint ventures.[5]

Limitations

However, there may be certain limitations on the utility of importing and distribution in the United States. First, US importation may not be feasible for heavy or bulky products. Nor does importing, without additional US activities, permit potentially lucrative service arrangements or similar contracts with customers.

Second, the simplicity of such an approach to the US market may be somewhat more apparent than real. Various US tariffs, quotas, Buy American restrictions of federal and/or state governments, alleged violations of others' US trademarks or copyrights or patents, antidumping and countervailing duty

5 See ch VI infra.

laws, and other barriers may limit imports at any time. So may high foreign exchange values that increase the US dollar prices of imported goods.

US antitrust laws also limit the pricing, territorial and other restrictions which may be placed upon US distributors and their dealings with possible competitors of the foreign producer. US protection for patents, trademarks, and other intellectual property of the foreign importer with respect to imported items must be obtained, just as when a licensing arrangement is used. Contractual arrangements with US purchasers also must cover potential US product liability and other insurance risks; provide reasonable assurance of payment for imported products, including possible security interests in goods delivered; and cover a variety of other common US sales issues.[6]

Third, state and local inventory or property taxes may apply to an importer or distributor's US goods and other assets. If US servicing or other business operations are involved, then federal, state, and/or local income and business taxes generally will be payable. These may raise issues of the proper allocation of expenses to the US operations, and of arm's length pricing – eg, if the price charged to the US operation is too high, its taxable income will be too low and may be redetermined by US tax authorities.[7]

Wholly owned or acquired US business enterprise

A third key alternative to a US joint venture is the establishment or acquisition of a US business enterprise wholly owned by the foreign investor.

Advantages

A common reason for establishing or acquiring such a US business enterprise is the desire of a foreign investor – whether a large multinational corporation or foreign bank or even a medium-sized foreign enterprise – to increase its access to the US market for goods, services, and technology, or to US raw materials or minerals, or to increase the portion of its assets invested within the US free enterprise system. A wholly owned US business allows total control by the foreign owner, and reduces risks of future difference with or competition from a joint venturer.

The foreign investor may also be increasingly concerned that foreign exports to the United States may be excluded by US tariff or other barriers, or may be priced out of the US market by the increased value of foreign exchange in US dollars, or by increasing labour and other costs abroad. By contrast, the cost of establishing or acquiring a US business may be reduced due to increases in the value of foreign exchange in US dollars, or to reduced market prices of US

6 On such restrictions, intellectual property protection, and contractual arrangements, see also J. Forry, supra fn 3, chs I, V and VI.
7 See generally ch VI infra.

corporate stock. Acquisition of an existing business also may provide access to technology owned by the US business.

For an alien individual interested in spending a period in the United States, a wholly owned US business also may help provide a basis for temporary or permanent entry into the United States, or a firm economic base in the United States.[8]

Limitations

There are various potential limitations on the utility of such a wholly owned US enterprise as an alternative to a joint venture. The US business may require substantial capital investment; extensive US marketing, manufacturing, technological, and/or commercial knowhow; and substantial US-based personnel with local compensation, housing, and/or immigration compliance arrangements.

Perhaps more importantly, establishing a new US business generally will require substantial time delays. The alternative of acquiring an existing business entails the risk of being tied economically to an unsuitable enterprise chosen without adequate knowledge of the US market.

Moreover, wholly or substantially foreign owned investments may be legally restricted by federal or state rules for certain industries or properties. These include, eg, banking, insurance, government defense contracting, communications, power, maritime or air transportation, railroads, and even fishing operations. Agricultural, grazing, or timber properties and oil, gas, or other mineral interests also may involve federal or state restrictions on foreign investment.[9]

ALTERNATIVES FOR US REAL ESTATE AND NATURAL RESOURCE INVESTMENTS

Use of independent brokers and managers

For a foreign investor in US real estate or other natural resources, one key alternative to the use of a US joint venture is reliance on independent brokers and independent property or resource managers.

Advantage

The important advantage here is the avoidance of the need for substantial US-based personnel and associated costs from the foreign investor.

8 See generally ch VIII infra.
9 For general descriptions of such restrictions, see J. Forry, supra fn 3, chs III and VI. For discussion particularly of certain restrictions on US real estate and natural resources investments by foreign investors, see ch IV infra.

However, this does not reduce the foreign capital required for the investment itself. Nor does it alter the potential application of US property investment restrictions on foreign investors, or the general US property taxation of the operation and disposition of the investment, as discussed more fully in subsequent chapters.[10]

Limitations

There are certain potential limitations on the utility of this approach for such investments. The foreign owners' control over the management, development, and operation of the property or resource investment may be less than if employees – or if partners with a similar economic interest in the investment's long-term success – are involved in the management. For large or multiple projects, use of US-based partners or employees may also be less expensive than paying the fees and/or commissions of independent managers.

Use of local employees

Another alternative to a joint venture is the use of local employees of the foreign owner to acquire, develop, manage, and/or dispose of US properties.

Advantage

The important advantage here is direct control by the foreign owner.

Limitations

Among the potential limitations of this approach, it should be noted that substantial US-based employees require local compensation, housing, and/or immigration arrangements; compliance with extensive federal and state employment laws; and in certain cases compliance with local broker licensing requirements. These may well be too costly and troublesome for the foreign investor to handle alone where small or few properties are involved.

Moreover, it is often extremely difficult to locate – and too costly to hire on a full-time basis – senior personnel for property development and management (as opposed to lower level employees for day-to-day operations) who are adequately experienced in each geographical area and type of property within the United States which may be of interest to the foreign investor. For access to these senior individuals, a partnership or joint venture arrangement for a project or a group of projects with a pattern of similar joint ventures will often be quite useful.

10 See chs IV and VI infra.

CONCLUSION

As a result of weighing advantages and limitations such as those described above, a foreign investor may conclude that none of the key alternatives frequently contemplated for US activities or investments fully meets the investor's requirements. Then a joint venture for the United States should be considered, either instead of or in addition to other approaches. The balance of this volume is devoted to basic forms and terms, special research and real property investment considerations, antitrust compliance, tax planning and financing, personnel transfers, reporting and other selected matters involved in such joint ventures.