StartRight Off-Shoring Guide

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Delaware

In total, there are several well-known geographical jurisdictions that offer considerable offshoring incentives. The key to choosing the most suitable offshore jurisdiction is to fully understand the extent of the incentives offered by each jurisdiction, how they impact your business in Egypt, and how much you can financially invest in any of them.

There are elements that may allow you to determine which jurisdiction is the best for your business such as the geographic territory, the forms of companies in that jurisdiction, the duration of incorporation, the requirement of a bank account for incorporation, the tax rates, the minimum number of directors and shareholders, the types of legal systems, the publicity of corporate information, the economic substance requirements, the foreign ownership ratio, the setup fees, the ongoing annual fees, and the requirement of a local agent or director.

Disclaimer: this guide should not in any manner be interpreted or considered as a legal advice or a tax advice.

1. **Corporate Structure:** The main differences between an LLC and a C-Corp are in their ownership structure and control. C-Corps are owned by shareholders

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and managed by a Board of Directors while LLCs are controlled by members whereby the terms of control are set out in an Operating Agreement.

Another difference is in the way C-Corp and LLC business entities are taxed, and this is often the determining factor for many clients. 1 C-Corps are often subject to "double taxation," where the corporation pays a tax on business income at a corporate tax rate and shareholders also pay a tax on profits distributed to them at a personal income tax rate. On the other hand, LLCs can be taxed like other entities (disregarded entity, partnership, or S-Corporation), which deem profits to be distributed and taxed as personal income even if they were re-invested in the business. While that does not trigger double taxation, taxing an LLC as a partnership or S-Corporation results in a higher effective tax rate than a C-Corp.

A C-Corp might be the best option when a startup seeks quick growth and expects to receive funding from outside investors and/or venture capital in the future, but also expects losses for extended periods that would be "rolled" forward every year to offset any future gains. Startups that endure years of losses before reaching profitable scale do not distribute profits created as dividends to shareholders. Rather, they invest these profits in the business, which results in a relatively lower effective tax rate to be

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paid where no personal income tax is due by shareholders in that case.

StartRight Recommendation:

Research suggests that the choice between an LLC and C-Corp should be based on whether a given startup is at the point where it is seeking venture capital investment. If a startup is at that point, a C-Corp may be the optimal choice given investors' general preference for it.

In addition to the benefits discussed above, investors often prefer C-Corps because they have adapted well to venture capital and angel investments. The laws in Delaware are notorious for protecting investors, and the laws and procedures there have developed over time creating a familiarity that streamlines procedures (financial and legal), which increases efficiency and valuations.

Theoretically, a C-Corp is the better choice if a startup is still reinvesting its profits in the business and not distributing them as dividends to shareholders. At such a stage, the tax due would only be a corporate tax and no dividends/profits would be distributed to shareholders, rendering no personal income tax due by the

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shareholders. This would result in no "double taxation," and subsequently, a relatively low tax rate.

2. Types of Shares

Issued shares are those that are issued to a shareholder in consideration for payment of money or services. Issued shares represent an ownership interest in the company. **The Board of Directors must approve every issuance of shares and has complete discretion to determine the purchase price for each share, subject only to the duty to act in the best interest of the company and its shareholders.**

It must be noted that preferred shares are not issued until the terms have been agreed with an investor, which requires a Board and the Shareholders' approval.

3. Corporate Governance

At least (1) director is required. There are no residency or citizenship requirements for directors or shareholders.

Delaware law requires that directors be elected annually at an annual shareholders' meeting. The meeting for close corporations is typically not held in person, but done in writing by written consent and must be signed by the holders of a majority of shares. Notice of such meeting action must be delivered to shareholders not signing the consent promptly after the meeting.

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There is no penalty for not holding an annual shareholders' meeting, but if a meeting is not held within 13 months of the prior meeting, any shareholder may petition a Delaware court to require the meeting be held. In addition, if corporate formalities, such as the election of directors, are not adhered to, it could be a basis for a litigant to challenge the limited liability protections of the corporate form.

With few exceptions (merger, sale of all or substantially all of assets, amendments to charter and liquidation), **all matters require approval only of a majority of directors**. When shareholder approval is required, the holders of a majority of shares can approve the action. **There are no actions that require approval of more than a simple majority of shares.**

4. Set-Up Fees

Total Set-Up Fees are around **USD 700** comprising the following items:

- Company Formation Fees are around USD 200; plus
- American Legal Counsel Fees which are around USD 500.

5. Set-up Duration

2-3 Business Days

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6. Economic Substance Requirement	None is required. However, changing the Holding Company to be operating or offering its products or services in the US would probably entail a different legal and tax treatment alike.
7. US Corporate Income Tax	It is a **flat 21% on taxable income**. This is something startups might not have to worry about at the beginning but could hurt them later on, especially if there are dividends transferred from the Egyptian subsidiary to the Delaware HoldCo.
8. US Dividends Tax	Dividends (i.e., distributions of profits) from a U.S. business are taxable in the U.S. For more information, visit the below link: https://www.investopedia.com/ask/answers/090415/dividend-income-taxable.asp
9. US Capital Gains Tax	None for Non-US tax residents. **As for U.S. citizens and residents, they might be liable to pay taxes at rates ranging from 0 to 37.5%, depending on the type and amount of income even those pertaining to the sale of their stock.**
10. Delaware Franchise Tax	As of 2022, the minimum franchise tax/annual report fee is USD 225-450, depending on the number of authorized shares (5,000 or fewer is USD 225, increasing to USD 450 if you have 10 million authorized shares). **As long as your net assets as of year-end are less than**

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around $1 million, you should always pay the minimum tax. The methods for calculating the tax are explained here: https://www.delawareinc.com/delaware-franchise-tax/

11. Delaware State Tax	U.S. states collect corporate income tax based on activities within each state provided that the corporation is subject to tax in that state, generally governed by whether the corporation is legally present or has employees in that state. The rules for such determination and the amount of tax due are impossible to summarize here, and require the expert advice of an accountant or tax attorney. However, a Delaware corporation is not subject to Delaware corporate income tax unless it has an office address in the state, other than the address of the registered agent.
12. US Federal Income Tax Returns	A U.S. federal corporate income tax return (Form 1120) is required to be filed every year, regardless of whether there was activity or income. The return is due by March 15 for the prior year. Information may be found at the IRS's website. https://www.irs.gov/forms-pubs/about-form-1120

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If at least 25% of the stock is owned by a non-U.S. person(s) or corporation(s) and your company engages in a "reportable transaction", you are required to file a Form 5472 with your tax return identifying the non-U.S. owners. Failure to file Form 5472 could result in a $10,000 penalty. A reportable transaction is any type of monetary transaction (for example, sales, rents, salary, etc.) with a foreign related party. Information about this form may be found here:

https://www.irs.gov/forms-pubs/about-form-5472
https://www.irs.gov/pub/irs-pdf/i5472.pdf

In lieu of hiring an accountant, commercial software may be purchased to prepare and file the return for about $100 if your return would show little or no income.

https://www.taxact.com/business-returns

13. Fillings for Foreign Investments in the US

Foreign investors in U.S. businesses must report their investments to the U.S. Department of Commerce's Bureau of Economic Analysis on Form BE-13. The filing is required within 45 days following the formation or investment in a U.S. legal entity in which more than ten percent of the voting interests in such entity are owned by persons outside the U.S.

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If your investment is or is forecasted to be less than $3 million, you are required to file BE-13 Claim for Exemption. If the amount of your investment is more than $3 million, you are required to file Form BE-13A. If the amount of your investment is expected to exceed $3 million, you are required to file Form BE-13B.

For copies of the forms and instructions and further information, please visit the following:

https://www.bea.gov/surveys/be13

http://swalegal.com/media-post/mandatory-form-13-filing-foreign-direct-investments-us-companies-real-estate-back/

14. Other Information on Taxes

You can search online for a company that prepares your tax filings. Below is one firm that performs such services primarily for international clients: https://www.greenbacktaxservices.com/

Other than the Delaware Annual Report and tax filings (discussed below), there are no regular reporting obligations of U.S. corporations. No U.S. federal or state governmental authority collects information on a corporation's shareholders.

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Check this below link for a full analysis of the applicable taxes on US Corporate Entities:
https://taxsummaries.pwc.com/united-states/corporate/significant-developments

15. Bank Account Issues	Each U.S. bank has different requirements for opening a bank account. In this regard, U.S. banks are subject to "know your customer" rules, which require banks to adhere to strict procedures to verify the identity of the client and its owners. **As a result, it is always the case that a bank account must be opened in person by an officer of the company for any Holding Company. More importantly, it is way easier and faster to be done if one of the founders has a Social Security Number. Otherwise, the Holding's founders will have to obtain an ITIN Number which could take months to be obtained.** This means that you can incorporate a Holding Company in Delaware but remains without a bank account in the US for such a Holding Company. For further information on how to obtain an ITIN Number, follow the below link: https://www.irs.gov/individuals/how-do-i-apply-for-an-itin
16. Delaware Annual Report	Delaware requires a corporation to file an Annual Report each year indicating the total number of issued shares, and the names and addresses (which can be the company address) of each officer and

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director. This information is not searchable online, but can be requested in writing by the general public for a fee. The report is due by March 1 of every year, and can be filed online. There is a franchise tax due and paid when filing the report, which may be paid via ACH or credit card (depending on the amount). **There is a penalty of $200 plus interest for late filing**. Your registered agent may assist in filing the report, but you can also file it directly online here: https://corp.delaware.gov/paytaxes/

17. Registered Agent Requirement

Each Delaware corporation is required to have a person with a business address in the State of Delaware authorized to receive legal communications on behalf of the corporation, such as notices of taxes and litigation. There are various service companies that perform this service. The cost is around $50-100/per year. **Failure to appoint and maintain a registered agent will result in the prompt suspension of your company, which will cost several hundred dollars in filing and attorneys' fees to reinstate.**

Please note that general business/customer correspondence is not included in this service and would require that you pay for mail forwarding service or a virtual office address. This is not a legal requirement. The cost varies widely depending on the number of mail pieces. As an example, Harvard Business Services charges $99

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for 25 mail forwards and $299/year for up to 520 forwarded mail pieces digitally.

18. Other Red Flags

Hidden Governmental & Hefty American Lawyering Fees:
Any amendment to the Articles of Association of the Company to allow for ins and outs of individual and institutional investors will cost governmental fees around USD 300 per amendment. These fees are exclusive of the US attorney billable hours which start around USD 150-250/Hour for this type of work.

Conclusion: Viability as a HoldCo for an Egyptian Subsidiary:

Pros:

1. **Minimal Incorporation Fees;**
2. **Speedy Incorporation Process;**
3. **Has a Double-Taxation Treaty with Egypt;**
4. **Provides an Investor-Friendly Vehicle,**

Cons:

1. **Hidden Governmental Fees;**
2. **Hefty American Lawyering Fees;**
3. **Needs Great Diligence with Taxes and how to treat them especially for US Citizens and Residents amongst the Founders;**
4. **Will Hinder working with any entity on the US Economic Sanctions List;**

especially for US-based VCs.

5. **Bank Account opening is very challenging for anyone without a US Social Security Number;**
6. **Delaware will not be friendly for any profit-generating startup in terms of taxes**

StartRight Final Words on Delaware

Do not be swayed with the minimal incorporation fees and the speedy incorporation process and try to think long-term. StartRight does not generally recommend Delaware for any Egyptian startup to off-shore. It has to be studied and examined carefully. Otherwise, it be a huge pain and an unrelenting holding vehicle.

StartRight Off-Shoring Next Episode: <u>Netherlands</u>

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