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How Foreign Franchisors Can Expand into the United States Using Foreign Franchisees

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Introduction

Foreign-based franchisors may wonder how difficult it would be to expand their businesses into the United States. Although ensuring compliance with local franchising laws is essential, it is not the only challenge that foreign-based franchisors will face when attempting to establish a presence in the United States.

For example, most foreign-based franchisors will not have the same level of brand recognition in the United States as they will have in their own countries. For this reason, it may be much more difficult to find potential franchisees in the target country.

One possible solution is for the foreign-based franchisor to initially sell its U.S. franchises to citizens of its home country, or citizens of other countries where it may already have an established presence. This solution offers significant advantages because many of the potential franchisees from these countries will be familiar with the franchisor's brand name and business operations abroad. However, it also creates an additional layer of complexity for franchisors, who will now need to advise their foreign franchisees on applicable U.S. immigration laws.

Fortunately, in most cases, a foreign franchisee will be eligible to own and operate a franchised business under the E-2 treaty investor category. A summary of key E-2 eligibility requirements is provided below.

E-2 Treaty Investor Status Available to Specific Nationalities Only

The basis for E-2 treaty investor category lies in treaties that are intended to enhance and facilitate economic and commercial interaction between the United States and the treaty country. Many countries (including Canada) already have an eligible treaty in force with the United States; a complete list of these eligible countries appears here.

Provided that the foreign franchisor's home country, or other country where the franchisor has an established presence, has an eligible treaty with the United States, its citizens will be eligible to seek an E-2 visa. However, E-2 eligibility does not extend to permanent residents of those eligible treaty countries.

The Foreign Franchisee Must Make a Qualifying Investment in the United States

In order to qualify for an E-2 visa, the foreign franchisee must have made a qualifying investment in the treaty business. To establish this qualifying investment, the following must be established:

a. The foreign franchisee must be in possession and control over the capital invested. In other words, he or she must have acquired the investment funds by legitimate means (savings, gift, inheritance, contest, etc.) and have control/possession over the invested funds.

b. Capital in the process of being invested or that has been invested must be irrevocably committed to the enterprise. Therefore, a significant portion of the investment must already have been spent in furtherance of the franchised business before an E-2 visa will be issued.

c. The qualifying investment must be at risk in the commercial sense with the objective of generating a profit. In other words, the investment must come from the foreign franchisee's personal capital or, if a loan is obtained, it must not be secured on the assets of the franchised business.

The Foreign Franchisor's Investment Must Be Substantial

The foreign franchisee's qualifying investment in the treaty business must also be considered substantial. The official position of the United States Department of State ("DOS") is that there is no set minimum dollar amount that will be considered "substantial" for the purposes of E-2 eligibility. Instead, U.S. consular officers apply what is known as the proportionality test.

The proportionality test is a comparison between two figures:

a. The amount of qualifying funds invested; and

b. The cost of an established business or, if a newly created business, the cost of establishing such a business.

The lower the cost of the business, the higher the percentage the qualifying investment must be.

The question of whether a proposed investment will be considered substantial is very discretionary matter. According to the current version of the *Foreign Affairs Manual* ("FAM"), investments of 100% or higher would normally automatically qualify for a small business of

$100,000 or less. At the other extreme, an investment of $10 million in a $100 million business would likely qualify, based on the sheer magnitude of the investment itself.

The examples provided in the current FAM are not very illustrative. However, a prior version of the FAM did include the following specific examples of acceptable proportionality:

a. In the case of a $50,000 investment, an investment approaching 90-100% would easily meet the test;

b. A business costing $100,000 might require an investment of 75-100% to meet the test;

c. A business costing $500,000 would demand generally upwards of a 60% investment, with a $375,000 investment clearly meeting the test;

d. In the case of a million-dollar business, a lesser percentage might be needed, but a 50-60% investment would qualify;

e. A business requiring $10 million to purchase or establish would require a much lower percentage—a $3 million investment might suffice in view of the sheer magnitude of the dollar amount invested; and

f. An investment of $10 million in a $100 million business would qualify based on the sheer magnitude of the investment itself.

The above examples were later deleted from the FAM because too many consular officers were interpreting them as bright line tests. Nevertheless, they can still be useful as examples of acceptable proportionality.

Despite the official DOS position that there is no minimum dollar amount, in practice, many U.S. consular posts still apply an unofficial minimum dollar threshold, in addition to the proportionality test. This threshold will vary depending on the particular consular post.

For E-2 visa applications filed at U.S. consular posts located in Canada, a proposed investment of $75,000 or higher (preferably closer to $100,000) is normally sufficient to satisfy the unofficial minimum dollar threshold. An investment as low as $50,000 may be acceptable in specific cases, but the chances of a denial will be much greater at this level of investment.

Franchised Business Must Not Be a Marginal Enterprise

In order to qualify for an E-2 treaty investor visa, it must be established that the franchised business is not a "marginal enterprise." This term is defined as an enterprise that does not have a present or future capacity to generate more than enough income to provide a minimal living for the treaty investor and his or her dependents. In the case of future capacity (i.e. new business), this should be realizable within five years from the date that the foreign franchisee commences business operations in the United States. Typically, the foreign franchisor will need to demonstrate that the franchised business will support several U.S. employees and still earn sufficient net income to support the foreign franchisor and his or her dependents, within the first five years of business.

Foreign Franchisee Must Develop and Direct the Treaty Business

An E-2 treaty investor must be seeking entry solely to develop and direct the treaty business. The ability to develop and direct can normally be established by owning at least 50% of the treaty business (if the applicant retains full rights of control over that portion of the business and has not assigned them to another), by possessing operational control through a managerial position or other corporate device, or by other means.

Most franchisees will own 100% of their franchised business. However, franchise agreements often contain restrictions on how the franchisee can operate the business. If these restrictions are too onerous, it is possible that a consular officer could conclude that operational control has been transferred to the franchisor by contract. If this occurs, the foreign franchisee will no longer have the ability to develop and direct the treaty business.

The above issue was previously considered in the precedent decision of *Matter of Kung*, 17 I&N Dec. 260 (Comm'r 1978). In that case, the Commissioner concluded that a franchisee could still qualify for E-2 status if he or she retained sufficient control over the management of the business, including the ability:

a. To hire and fire employees;

b. To set wage scales; and

c. To set the hours of the business.

The franchise agreement considered in *Matter of Kung* was actually quite restrictive. Nevertheless, Commissioner concluded that the franchisee retained sufficient control over the treaty business.

In light of *Matter of Kung*, most franchisees should be able to demonstrate their ability to develop and direct the franchised business.

Hiring Foreign Employees

If a foreign franchisee is found to be eligible for an E-2 treaty investor visa as a principal investor, he or she may also hire foreign employees (if they hold the same nationality) who will be employed in an executive, supervisory, or essential skills capacity. This allows the foreign franchisee to send key employees to the United States in order to assist in the operation of the franchised business.

Executive or supervisory duties grant the employee ultimate control and responsibility for the enterprise's overall operation or a major component thereof. An executive position provides the employee great authority to determine the policies and direction of the enterprise. A supervisory position grants the employee supervisory responsibility for a significant proportion of an enterprise's operations and does not generally involve the direct supervision of low-level employees (i.e. first line supervisors will not qualify).

Essential skills workers are employees who have special qualifications that make the service to be rendered essential to the efficient operation of the treaty enterprise. In other words, it must be established that the employee possesses specialized skills and that those skills are needed by the treaty enterprise. It must also be established that the treaty investor has a long-term need for the employee's essential skills. Otherwise, the consular officer will expect the essential skills worker to eventually be replaced by a U.S. worker (typically within two years).

Duration of E-2 Visas

The maximum validity period for an E-2 visa will depend upon reciprocity with the foreign national's country of nationality. The maximum validity period for each country is shown in the reciprocity tables published by DOS; these reciprocity tables are available online. In many cases, the maximum duration of an E-2 visa will be five years at a time.

During the validity period of an E-2 visa, the visa holder may freely enter the United States Status in connection of the treaty business. They may also remain continuously in the United States for a maximum period of two years at a time.

There is no maximum limit on the number of years that an E-2 treaty investor may hold such status. As long as they remain eligible, E-2 treaty investors may continue to renew their E-2 visas indefinitely.

The long-term nature of the E-2 category ensures that foreign franchisees who establish franchised businesses in the United States will be allowed to continue operating these businesses for an extended period.

Conclusion

For the above reasons, foreign-based franchisors who are interested in expanding their businesses into the United States may wish to consider selling at least some of their U.S. locations to citizens of other eligible treaty countries, especially those countries where the company's brand is already well established. This will help to simplify the task of finding potential franchisees and may help to accelerate the company's expansion into the United States.