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The Flip Transaction: Bringing Your Foreign Startup into the U.S. Investment Market

By Roger Royse

Non-U.S. startups often arrive at the point where they wish to seek funding from a U.S. venture capital firm or establish a presence in the U.S. Sophisticated investors tend to prefer to invest in companies organized under Delaware law.

There are several reasons that foreign entrepreneurs should move their startup from their home countries to the U.S. The decision to relocate may result in an increased company valuation or attract additional financing. U.S. investors are likely to view companies that have reincorporated in the U.S. as a more attractive investment opportunity. Companies seeking to build relationships with local investors find this becomes an easier task by relocating the business to the U.S. Many foreign companies already see a sizable portion of their revenue coming out of the U.S., making a relocation to the U.S. a logical progression.

There are several ways to move a foreign startup to the U.S. For example, the foreign entity could be merged or converted into a new Delaware corporation. The owners of the foreign startup would become the shareholders of the surviving Delaware corporation. However, the most common solution for moving a foreign entity into the U.S. has been the “flip” transaction, in which the foreign entity’s shareholders create a new U.S. entity and exchange their foreign stock for the U.S. stock. Through this transaction, the original shareholders are now the owners of the U.S. entity, and the U.S. entity becomes the parent of the foreign entity. The company has been reincorporated in the U.S., thus satisfying the investor’s conditions to funding; angel investors and venture capital funds would then invest in the newly formed U.S. entity.

Consider the most common scenario:

Forco, a foreign startup, has filled a market need and has accelerating year-over-year growth. Without proper funding, Forco remains highly vulnerable to emerging, funded competitors. Forco has identified Investor, a U.S.-based angel investor or venture capital firm interested in investing. However, Investor has expressed discomfort with Forco’s foreign entity structure and foreign governing law. As a condition to funding, Investor requires Forco to reincorporate in the U.S. and the flip approach is selected. In the flip, Forco’s shareholders create a new U.S. entity (“Domco”) and exchange their Forco stock for Domco stock. After the exchange, the shareholders will own Domco, and Domco will own Forco. Investor invests into Domco.

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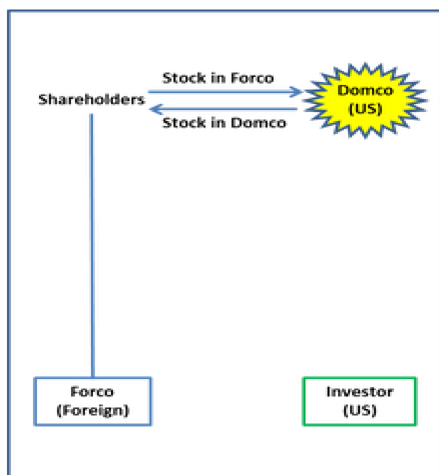

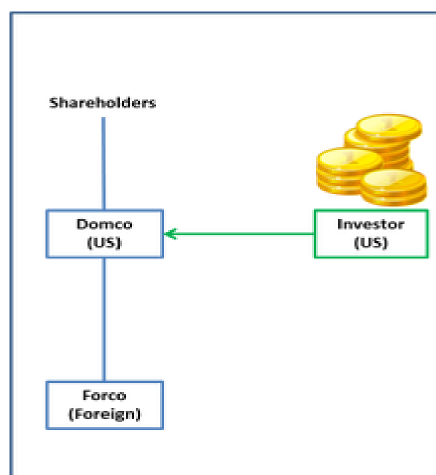

Foreign startups should generally not flip before securing U.S. investors, for several reasons. First, the flip eventually subjects the worldwide operation to U.S. tax because the new U.S. parent is taxed on its worldwide income. Second, a U.S. parent may discourage foreign VCs from investing in the business. In addition, foreign entrepreneurs and prospective U.S. investors should consider other issues such as the tax consequences of the flip to the shareholders of the foreign entity in their home jurisdictions, ownership and sharing of intellectual property rights between the U.S. parent and the foreign subsidiary, intercompany agreements, issuance of equity incentives to non-U.S. employees, review of shareholder agreements to conform to U.S. law, securities law compliance and the need for third-party consents or approvals under existing commercial contracts of the foreign entity.

A willingness to flip opens the world's top venture capital market to foreign startups. As the world gets smaller, foreign companies should consider a tax-efficient move to the U.S. for investment, new markets and talent.

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