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Congress may look at ‘inversion’ loophole

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Mylan headquarters in Canonsburg, Pennsylvania.

By Tracie Mauriello / Pittsburgh Post-Gazette

WASHINGTON — Lawmakers are expected to return from their August recess with proposals to close a loophole that allows companies such as Cecil’s Mylan Pharmaceuticals to avoid paying Uncle Sam by acquiring foreign competitors and reincorporating in countries with low or no corporate tax obligations.

But some analysts, economists and tax attorneys say action is unlikely in a deeply divided Congress, and a crackdown won’t deter companies, anyway.

That’s because the tax break is only one factor in companies’ decisions to incorporate overseas.

For Mylan, one of the other factors is that much of its profit stems from intellectual property, such as patents, which can easily be transferred overseas. Mylan recently acquired part of Abbott Laboratories and announced that the merged company would reincorporate in the Netherlands, allowing its taxes on foreign revenue to drop from 35 percent to about 20 percent, while its executive team remains in Cecil.

“The development of intellectual property abroad is helpful to pharmaceutical companies, so they go to the Netherlands and other countries that have more liberal regulatory policies,” said Fran Muracca, a Pittsburgh-based tax attorney and partner in the firm of Jones Day.

But that freedom can be a double-edged sword. Stock could plummet if shareholders don’t trust the foreign regulatory environment or the legal system that will adjudicate lawsuits that may arise.

“Will markets punish companies from being a Bermuda corporation because it follows British corporate law? Will [investors] be afraid these companies would be riskier because they are less regulated?” asked Adam H. Rosenzweig, a professor of international tax law at Washington University in St. Louis.

A common maneuver

Inversion maneuvers are common in a recovering economy ripe for mergers. For the first time in years, companies have capital to expand while technology improvements ease distribution, networking and business integration.

They are drawn overseas by a combination of factors including fewer regulations, Europe's unified monetary system and technological advances that allow real-time currency exchanges, Mr. Muracca said.

"You take all of those factors and it pushes companies toward finding foreign strategic partners in emerging markets," he said.

All the better if the country is a member of the European Union, because then the company can benefit from open trade.

"Ultimately it comes down to a business decision," Mr. Rosenzweig said. "If you want to do business in Europe, then why not structure it as an inversion?"

Tax reduction on foreign earnings sweetens the deal but isn't enough, on its own, to cause companies to reincorporate overseas, he said. If it were, then more companies would go to Bahrain, which doesn't tax foreign profits, instead of Ireland, which has a 12.5 percent tax rate.

The U.S. rate is 35 percent, the highest in the industrialized world.

Some Democrats say that the high U.S. rate is justified because of the country's stable financial markets, trade agreements and legal system. And some say that those who avoid paying it are unpatriotic tax-dodgers who are renouncing their citizenship to get out of paying their share.

But when competitors are inverting, the pressure to follow suit is even greater, said Philadelphia tax attorney Kevin Johnson, a partner at Pepper Hamilton. And in today's age of global trade and instant communications, the barriers to overseas reincorporation that might have existed decades ago are now gone.

"In every industry today, [there] are tremendous resources from Australia to Europe to Asia that can be tapped," Mr. Rosenzweig said. "The reality is that we are in a global economy now ... We have more consistency in currencies and we can access real-time information [on currency fluctuation] that we didn't have 25 years ago."

Inversions 'unpatriotic'?

The Obama administration has criticized inversions as unpatriotic — a characterization that prompted enough public outcry to deter retail giant Walgreens from inverting. But tax attorneys such as Robert Wood of San Francisco say the characterization is a red herring.

"I think it's very clever. You have to hand it to whoever thought of saying that an inversion is like a change of citizenship," he said. "When you start saying something about leaving America, you get all sorts of people who are highly agitated ... and want to bar the door if they ever want to come back."

Senate Finance Committee Chairman Ron Wyden, D-Ore., has been vocal about the need to curtail inversions before they erode the tax base. In a statement last week, he said he is eager to work on a solution when Congress returns from August recess.

"The issue demands a resolution in the near term," he said. "The inversion virus continues to plague our country."

Among the ideas are restricting companies from deducting foreign interest from their U.S. taxes through a practice known as earnings stripping, and not recognizing inversions when companies are majority-owned by U.S. investors. (Current law allows up to 80 percent U.S. ownership. In Mylan's case, it will own 79 percent of the inverted company.)

But some economists say neither of those solutions would dissuade foreign companies from fully taking over U.S. companies, and then benefiting from the same lower tax obligations they would have had under an inversion. And either measure would require support of Senate Republicans who prefer to simply lower the corporate tax rate across the board rather than address inversions separately.

If Congress fails to act, the White House could use executive power to unilaterally impose new regulations that, for example, would exclude inverted companies from government contracting.

Edward Hudgins, former senior economist for the Congressional Joint Economic Committee, said tough regulation signals deep problems that require more comprehensive solutions. (He is now director of advocacy and senior scholar at The Atlas Society, which advocates reason, individualism and freedom.)

Mr. Hudgins also cautioned that efforts to curb inversions might only encourage more companies to find other ways to invest overseas.

"When a central theme of Obama's ideology is to damn wealth creators as exploiters, is there any wonder that they shrug and take their money elsewhere?" he asked.

An estimated $2 trillion is already being kept overseas because companies don't want to pay the taxes it would take to bring it back to the U.S. to invest here. Mr. Muracca believes an amnesty program would be more help than anything Congress or the administration has been suggesting.

"Allow U.S. companies with foreign access to cash to repatriate that cash at a lower rate. That's an avenue to consider if [Congress is] looking for job creation and U.S. expansion," he said.

No matter what Congress does, corporations will always plan strategically around their tax obligations, whether or not "inversions" are available, Mr. Muracca predicts.

"We're going to continue to see very effective global tax planning across all industries as they look to [bring] about stronger shareholder earnings," he said.

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