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Inversions Go Mainstream, While They Last

By Robert W. Wood • Wood LLP • San Francisco

Go foreign, young man. If Horace Greely could update his iconic line, it would not be about going west, but about going for inversions. Such deals are atwitter in boardrooms, upsetting U.S. lawmakers, roiling European companies and worrying U.K. lawmakers.

The latest deal involves generic drugmaker Mylan, Inc., which announced its purchase of Abbott Laboratories' branded specialty and generics business outside the United States. The value? $5.3 billion. In a familiar pattern, the deal is being promoted as bolstering the company's product line.

Oh, by the way, it will also cut the company's tax bill. By moving its tax address outside the United States, Mylan is joining the ranks of healthcare companies and others doing inversions. Abbott will transfer assets to a new publicly traded company in the Netherlands that will also include Mylan's existing businesses.

In exchange, Abbott will receive 105 million shares of the combined company. That tallies to an ownership stake of 21 percent, worth $5.3 billion. In concept, the deals are simple, not unlike a marriage. If you were to marry a foreigner—a non-U.S. person not subject to tax filings with the IRS—suppose you could stop paying U.S. taxes?

You have to admit that if this were the law, a foreign fiancée would bring a rather astounding dowry to the table: not paying U.S. taxes, perhaps forever. Taxes can be strong motivators, given that they take an increasing share of your earnings and wealth. This hypothetical may sound silly since the tax law is clear that marrying a foreigner doesn't change your own U.S. tax status.

But consider that a merger or acquisition is a type of corporate marriage. Pfizer was unsuccessful in combining with the British company AstraZeneca. Many U.S. companies are trying to get hitched to corporate spouses abroad. Odds are that a lot of modern corporate-style singles ads are being penned right now.

ALSO IN THIS ISSUE

For a U.S. company, the goal is to move its domicile abroad so that it is no longer subject to U.S. corporate taxes. Of course, companies cannot just up and move their headquarters to Ireland since there's no marriage involved in that. Even with the appropriate deal with a foreign company, the tax-avoidance move does not work for the actual U.S. earnings of the company.

Yet, an inversion can shield all the combined companies' income sourced outside the U.S. from the high 35-percent U.S. corporate tax rate. Without the inversion, it would all be taxed in America. U.S. tax law started cracking down on inversions way back in 2004, and even before. U.S. companies looking for a foreign partner usually stress the business synergy, not taxes.

Still, the foreign nature of the partner can be pretty alluring. If you can locate and buy a foreign company, that is a start. But be sure to arrange it so the foreign company acquires the American one or a holding company is formed to wed the two suitors. Make sure that more than 20 percent of the post-marriage combination is owned by the foreigners when the smoke clears.

If so, a not terribly attractive American company can effectively start sporting a beret. Pre-inversion, the American company had its feet firmly planted in the U.S. tax code. Post-inversion, with a sophisticated, global spouse, the company can stop being domiciled in the U.S. That means U.S. taxes go down materially.

Congress has fired up its tax writers to go after these would-be corporate Eduardo Saverins. Section 7874 of the Internal Revenue Code already covers inversions, but it has failed to put a damper on the practice. Now, Congress is trying to make inversions much more restrictive. Under present proposals, the 20-percent rule for inversions would jump to a whopping 50 percent.

That would ensure that a foreign company would have to *really and truly* be the controlling buyer. If not, the dowry of tax benefits would be off. Meanwhile, inversion deals continue at the expense of the IRS and American taxpayers. Minneapolis-based Medtronic recently agreed to buy Dublin-based Covidien for $42.9 billion in cash and stock.

Medtronic is the world's largest stand-alone medical device maker, selling pacemakers, defibrillators, stents, *etc*., while Covidien makes devices used in surgical procedures, such as surgical staples, feeding pumps, ventilators, *etc*. Medtronic is the acquirer, but the deal allows Medtronic a key foreign headquarters. The party line is that the deal is about synergy with Covidien, not taxes.

In fact, Medtronic is going out of its way to downplay the inversion deal, something that seems astute after Pfizer's failed attempt to merge with AstraZeneca. Medtronic said operational headquarters would remain in Minneapolis. It even pledged $10 billion in U.S. technology investments over 10 years.

Yet it is clear that Medtronic's executive offices will be in Ireland, saving taxes. Medtronic is holding more than $14 billion in cash, most of it outside the U.S. since it doesn't pay taxes until it brings profits back. With different medical product lines, the deal

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seems unlikely to face antitrust problems. Although there will be synergies, it's hard not to think about taxes.

More than 40 large U.S. companies have recently gone foreign in this way. At 35 percent, U.S. corporate tax rates are high. Ireland's tax rate is 12.5 percent, and many companies take advantage of that Irish bargain through a variety of techniques. Apple may be the most prominent example of Irish operations *sans* inversion.

According to a Senate report, Apple avoided paying $9 billion in U.S. taxes in one year. For many U.S. companies with sales growth in China or India, the prospect of having all income taxed in the U.S. is daunting. As one competitor cuts its effective tax rate by, say, 10 percent, others must stay competitive.

Congress is likely to persist in its struggle to restrict inversions and make them more foreign. And scrutiny is coming from abroad, too. Some in U.K. Prime Minister David Cameron's government have suggested adding increased protection for British companies in takeover negotiations where there is a national interest at stake.

Meanwhile, expect American companies to keep looking for foreign matches, and to say that none of it is about taxes.