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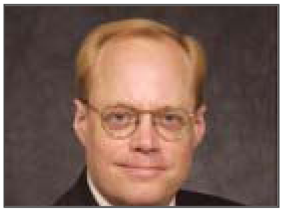

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Medtronic To Buy Covidien, Go Irish, Says It's Not About Offshore Taxes

Medtronic has agreed to buy 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. The marriage will rival the biggest in the medical device industry, Johnson & Johnson.

Oh, Medtronic gets Ireland in the deal, which not coincidentally should slash its taxes. The party line is that the deal is about synergy with Covidien, not taxes. Medtronic is going out of its way to downplay the inversion deal, something that seems smart 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. Still, it's clear executive offices will be in Ireland, saving taxes.

Ireland (Photo credit: NASA Goddard Photo and Video)

Medtronic Chief Executive Omar Ishrak said Medtronic's corporate tax rate will remain around 18 percent. Yet 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. That and other facts make the tax aspects of this deal huge.

With different lines, the deal seems unlikely to face antitrust problems. Although there will be synergies, it's hard not to think about taxes, and some drop for Medtronic seems inevitable. The deals are called “inversions” when a U.S. company moves its domicile so that it is no longer subject to U.S. corporate taxes.

Two recent inversion attempts failed. One was Pfizer’s bid for Britain’s AstraZeneca, and the other was Omnicom Group’s grab for France’s Publicis Groupe. Inversions don’t cut taxes on pure U.S. earnings, but can shield income around the world from the high 35% U.S. corporate tax rate.

U.S. tax law started cracking down on inversions a decade ago. One cannot simply move company headquarters. And if you try, you may get stuck paying a lot of extra taxes, penalties and interest.

However, a foreign partner can be pretty alluring. First locate a foreign company to buy. Arrange it so the foreign company acquires the American one, or a holding company is formed to merge the two suitors. Make sure more than 20% of the post marriage combination is owned by foreigners.

Result? No longer an American company stuck in the U.S. tax code, the sophisticated global enterprise can stop being domiciled in the U.S. That means U.S. taxes go down materially.

Congress has tried to prevent these before. Section 7874 of the tax code already covers these deals, but is complex and has failed to work. Now, Congress is trying to make inversions much more restrictive.

Under present proposals, the 20% rule for these inversions would jump to a whopping 50%. That would make sure a foreign company would have to *really and truly* be the controlling buyer. President Obama has suggested something similar.

Why have more than 40 companies recently gone foreign? U.S. corporate tax rates are high at 35%. Ireland’s tax rate is 12.5%. And many companies take advantage of it.

Apple may be the most prominent example, not of an inversion but of Irish operations. According to a recent Senate report, Apple, avoided paying $9 billion in U.S. taxes in one year.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.