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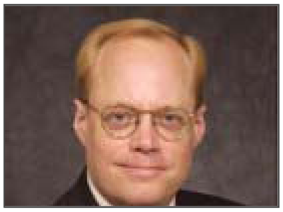

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THE TAX LAWYER

TAXES 7/16/2014

Obama Treasury Urges Halt Of Inversions For Foreign Headquarters & Tax Savings

Go foreign, young man. If Horace Greely could update his iconic line, it would not be to go west, but to have foreign headquarters. “Inversion” deals atwitter in boardrooms are upsetting U.S. and U.K. lawmakers and roiling European companies. President Obama wants it fixed, as a letter from Treasury Secretary Jack Lew states. He urges Congressional action to stop the offshore moves. Ways and Means Committee Ranking Member Sander Levin (D-MI) agrees, noting that “ordinary Americans can’t change their address to an overseas location in order to avoid paying taxes.”

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 companies doing inversions. Abbott will transfer assets to a new publicly-traded company in the Netherlands that will 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. Suppose you could stop paying U.S. taxes by marrying a non-U.S. person not subject to tax filings with the IRS?


Modeling the beret (Photo credit: Wikipedia)

If that were the law, a foreign fiancée would bring an astounding dowry: not paying U.S. taxes. Taxes can be strong motivators, taking an increasing share of your earnings and wealth. Of course, 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 Britain's 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. The goal is for a U.S. company to move its domicile outside the U.S. 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 doesn't 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% U.S. corporate tax rate.

Without the inversion, it would all be taxed in America. U.S. tax law started cracking down on inversions in 2004. U.S. companies looking for a foreign partner usually stress business synergies, not taxes. Still, the foreign nature of the partner can be pretty alluring. If you can locate and buy a foreign company, that's a start.

But be sure to arrange it so the foreign company acquires the American one, or a holding company is formed to merge the two suitors. Make sure that more than 20% 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 work. Now, Congress is trying to make inversions much more restrictive. Under present proposals, the 20% rule for inversions would jump to a whopping 50%.

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. 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. 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 abroad. It doesn't pay taxes until it brings profits back. 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%, U.S. corporate tax rates are high. Ireland's tax rate is 12.5%. And many companies take advantage of that Irish bargain through a variety of techniques. Apple may be the most prominent example, not of an inversion but of Irish operations. 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%, others must stay competitive. Still, Congress is likely to restrict inversions and make them more foreign.

Scrutiny is coming from abroad too. Some in UK 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.

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.