“HELEN OF TROY” INVERSIONS CONTINUE

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To the extent that the U.S. tax rules impose a greater burden on a domestic multinational corporation than on a similarly situated foreign multinational corporation, the domestic multinational company may have an incentive to undertake a restructuring, merger, or acquisition that has the consequence of replacing the domestic parent company of the multinational group with a foreign parent company. This type of transaction, in which a foreign corporation replaces a domestic corporation as the parent company of a multinational group, has been commonly referred to as an inversion.

Helen of Troy was a publicly traded cosmetic company that reorganized and inverted into a Bermuda company in 1993. This case was highly publicized; the I.R.S. responded by issuing Notice 94-46 (1994-1 C.B. 356), which announced some modifications to stop restructuring “for tax-motivated purposes.” The inversion of Helen of Troy reflected a convergence of several favorable factors. The company had a net operating loss shielding it from tax on required gain recognition. Its share price was down. A large proportion of its shareholders were either foreign investors or tax-exempt entities, neither of which were taxable in the event the conversion resulted in a gain.

Since the Notice was issued, many changes have been made or suggested to impede corporate inversions, but the solution has not been found. In 2004, Code §7874 was enacted with the intent of stopping inversions. It created a test whereby a foreign corporation could be treated as a U.S. corporation if 80% of its stock is owned by former shareholders of the domestic target. The Administration has proposed broadening the scope of Code §7874 by reducing the 80% test to a greater than 50% test.

Legislation introduced by Representative Sander Levin and Senator Carl Levin in 2014 is similar to the President’s proposal. Their bill would reduce the current 80% test to a greater than 50% threshold. The bill also contains a provision that would bar companies from shifting tax residency offshore if their management, control, and significant business operations remain in the U.S. In addition, the bill would be retroactive to May 8, 2014, if enacted.

POLICY CONCERNS AND POLICY GOALS

Policymakers have devoted much attention to corporate inversions, and many have expressed concern that current policy goals are in conflict with one another and may, therefore, require different responses. One concern expressed by policymakers is that cross-border acquisitions, specifically inversions, may trigger the loss of corporate tax revenue in the U.S. A report[1] by the Congressional Budget Office

[1] Congressional Budget Office, “The Budget and Economic Outlook: 2015 to 2025,” January 26, 2015, p. 98.

projects that corporate income tax revenue will decline from 2.3% of gross domestic product ("G.D.P.") in fiscal year 2016 to 1.8% of G.D.P. by fiscal year 2025. According to the report, inversions account for part of this decline.

The goal of protecting U.S. corporate tax revenue is in conflict with many other policy goals, such as the tax policy goal of complete neutrality toward cross border transactions. One of the suggested solutions is to minimize the disparity between a U.S.-parented group and a foreign-parented group by reducing the tax burdens on foreign profits of the U.S.-parented group. This would promote portfolio investment in the U.S and encourage U.S. companies to retain their existing U.S.-parented structures.

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In addition, some argue for stricter rules under Code §7874, believing that either the scope of Code §7874 should be broadened or that the tax benefits of inversions should be eliminated. The goal is to find a way to maximize domestic investment and employment and to discourage U.S. companies from moving their tax domiciles abroad for the purpose of avoiding U.S. Federal taxes.

Senator Orrin Hatch and his colleagues argue for a territorial tax system. Although Senator Hatch acknowledges that a territorial tax is not a "magic elixir," he believes that it is a "first and a very important step." Another possible avenue is to utilize Code §385, which authorizes the I.R.S. to prescribe regulations to determine whether an interest in a corporation is debt or equity. Harvard Professor Stephen Shay has advocated for the I.R.S. to be more aggressive in reclassifying interest payments as dividends, for which no deduction can be claimed.

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NOTICE 2014-55

On September 22, 2014, the I.R.S. and Treasury Department issued Notice 2014-55, which was intended to address avoidance of Code §7874 by restricting or eliminating certain tax benefits that come as a result of inversion transactions. Among other things, the notice describes regulations that the Treasury Department and I.R.S. intend to issue, which will include the following activities:

1. Addressing taxpayer planning designed to keep the percentage of the new foreign parent company stock that is held by former owners of the inverted domestic parent company (by reason of owning stock of the domestic parent) below the 80% or 60% threshold;

2. Restricting the tax-free post-inversion use of untaxed foreign subsidiary earnings to make loans to or stock purchases from certain foreign affiliates; and

3. Preventing taxpayers from avoiding U.S. taxation of pre-inversion earnings of foreign subsidiaries by engaging in post-inversion transactions that would end the controlled foreign corporation status of those subsidiaries.

It is not yet clear whether the new rules in Notice 2014-55 will stem the tide of inversions.