# U.S. TAX UPDATE –– INVERSIONS

- WHY ARE THEY?
- WHAT ARE THEY?
- LEGISLATION
- TREASURY REACTION
- MARKET RESPONSE

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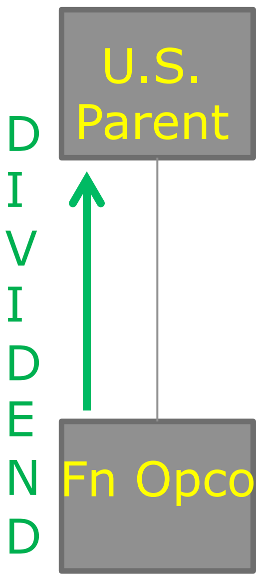
# WHY ARE THEY

# Multinational Group

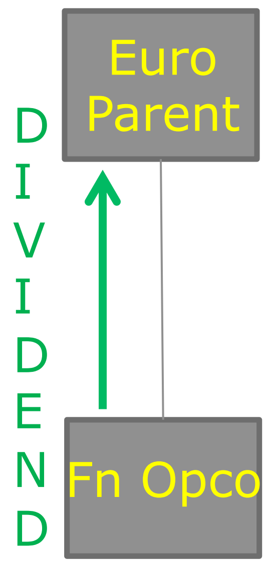
- U.S. Based




Domestic Tax Rate

- 38% to 40% combined rate on operating income
- 35% Fed. Rate on dividends from Fn OPCO, less foreign tax credit

- Euro Based




Home Country Tax Rate

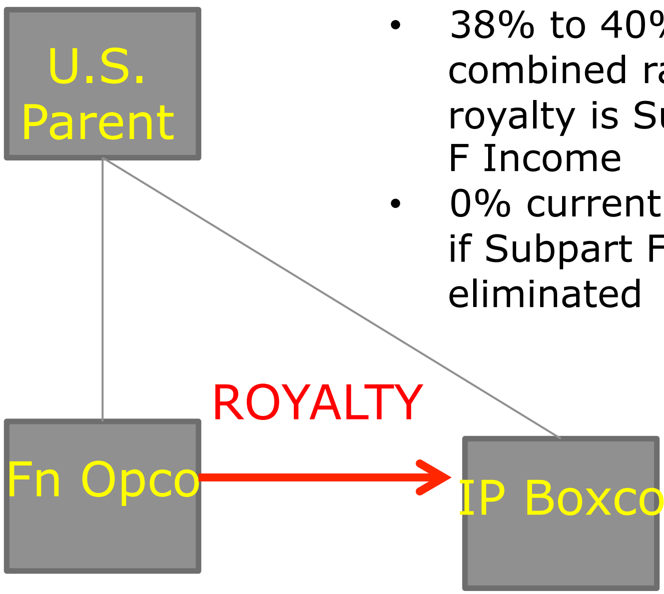
- 12.5% to ~30% combined rate on operating income
- 0% to 5% on dividends from Fn OPCO

# Multinational Group

- U.S. Based

<u>Domestic Tax Rate</u>

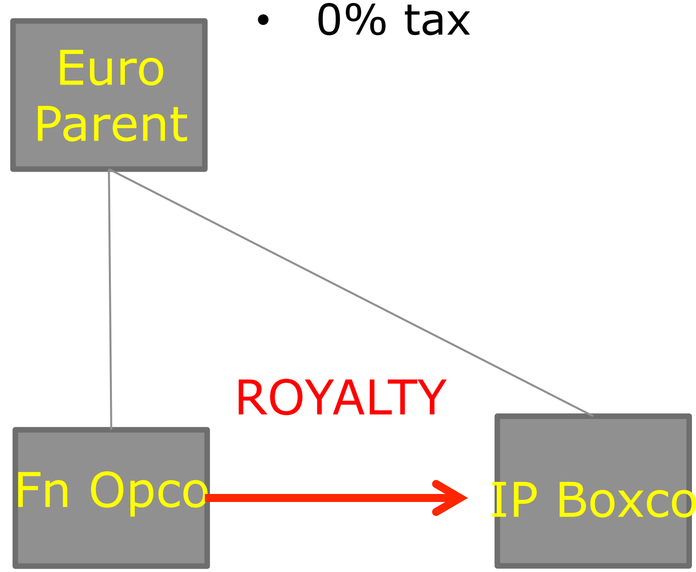
- 38% to 40% combined rate if royalty is Subpart F Income
- 0% current income if Subpart F risk is eliminated




- Euro Based

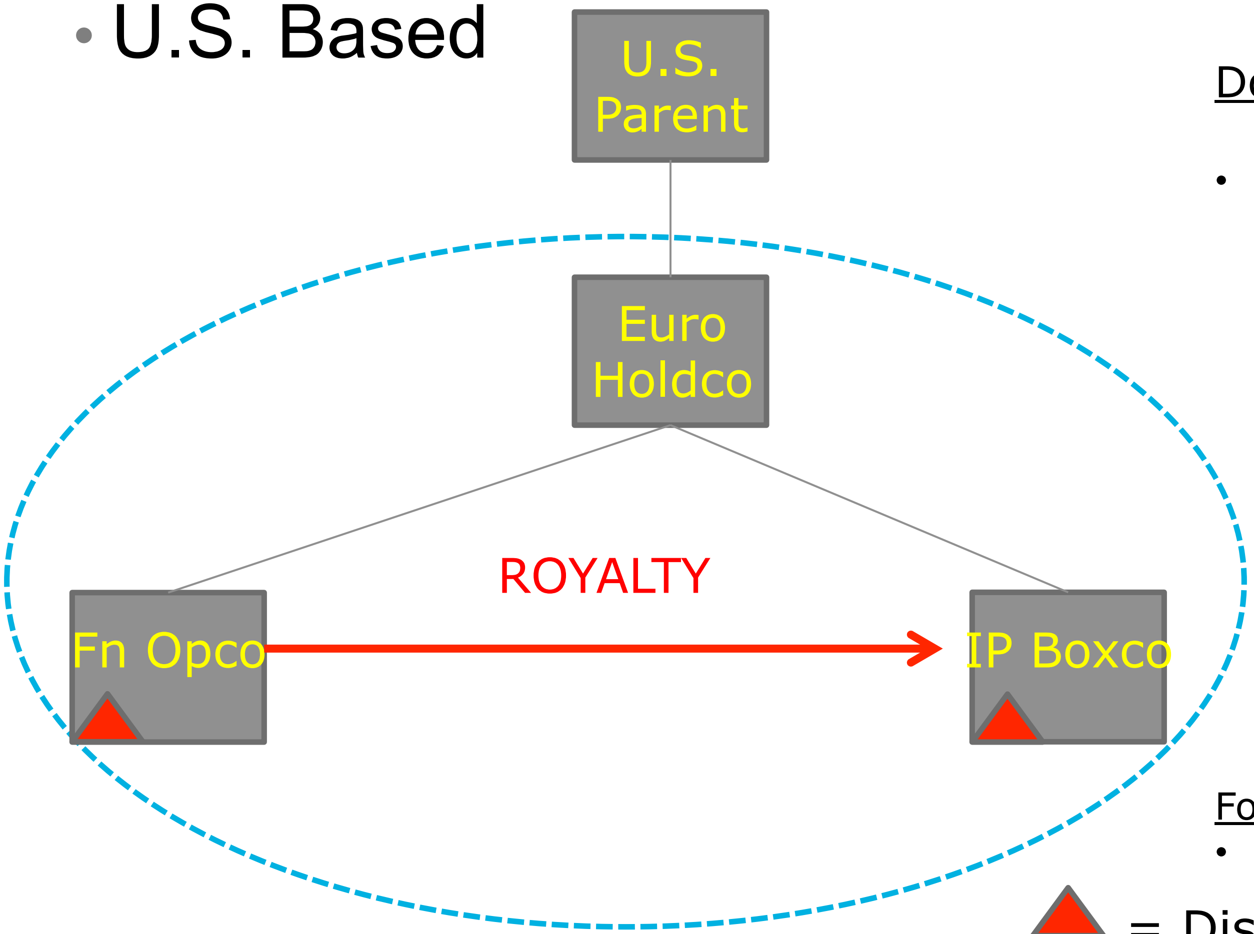
<u>Home Country Tax Rate</u>

- 0% tax



# Multinational Group

- U.S. Based




Domestic Tax Rate

- Subpart F income is eliminated if Fn Opco and IP Boxco are
  - Owned by the same HoldCo and
  - Make a check-the-Box election to be treated as branches of HoldCo

Foreign Tax Rate

- 5% to 10%

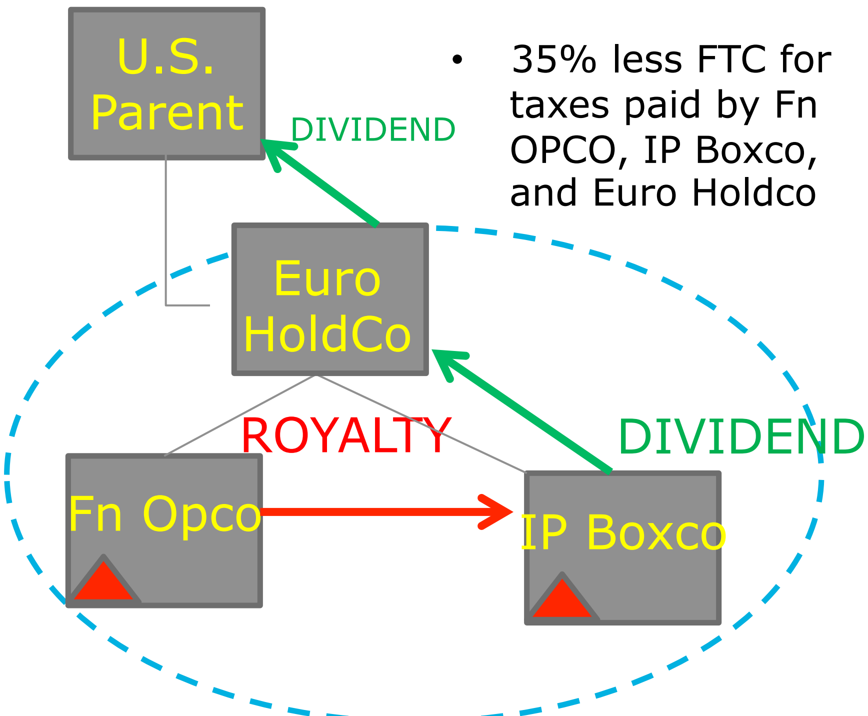
= Disregarded Entity

# Multinational Group

- U.S. Based

Domestic Tax Rate

- 35% less FTC for taxes paid by Fn OPCO, IP Boxco, and Euro Holdco

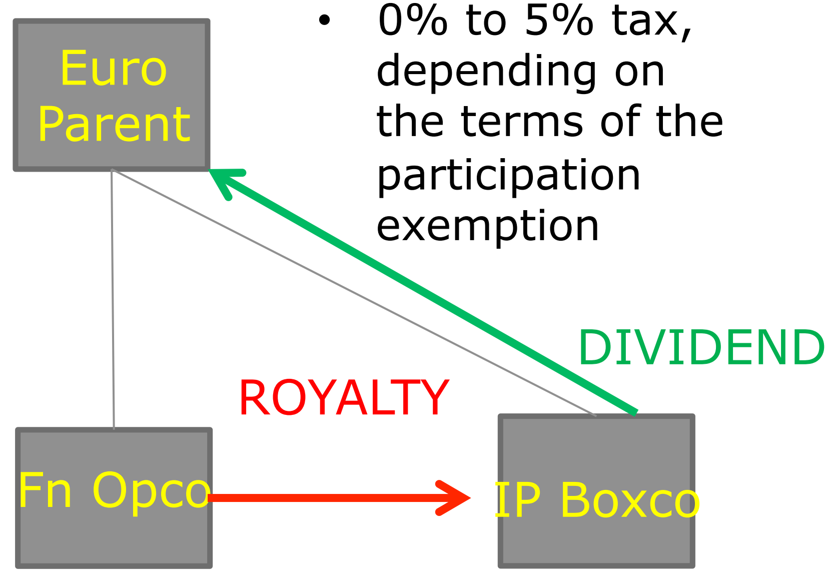



= Disregarded Entity

- Euro Based

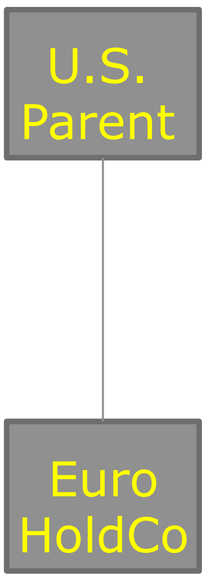
Domestic Tax Rate

- 0% to 5% tax, depending on the terms of the participation exemption



# Multinational Group

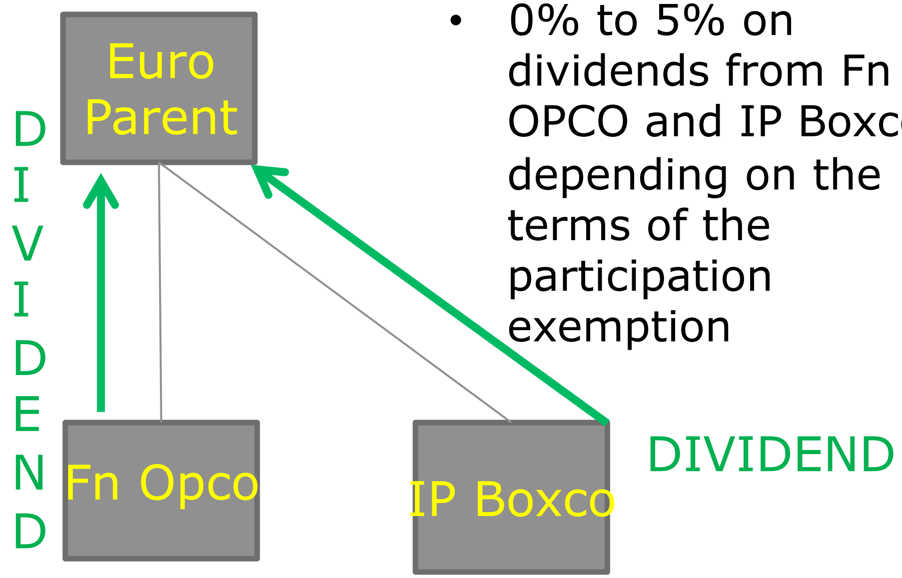
- U.S. Based




Domestic Tax Rate

- 0% if all earnings of Euro HoldCo and subsidiaries are accumulated
- But a deferred tax must be provided under ASC 740 for financial accounting purposes unless earnings are permanently reinvested abroad

- Euro Based

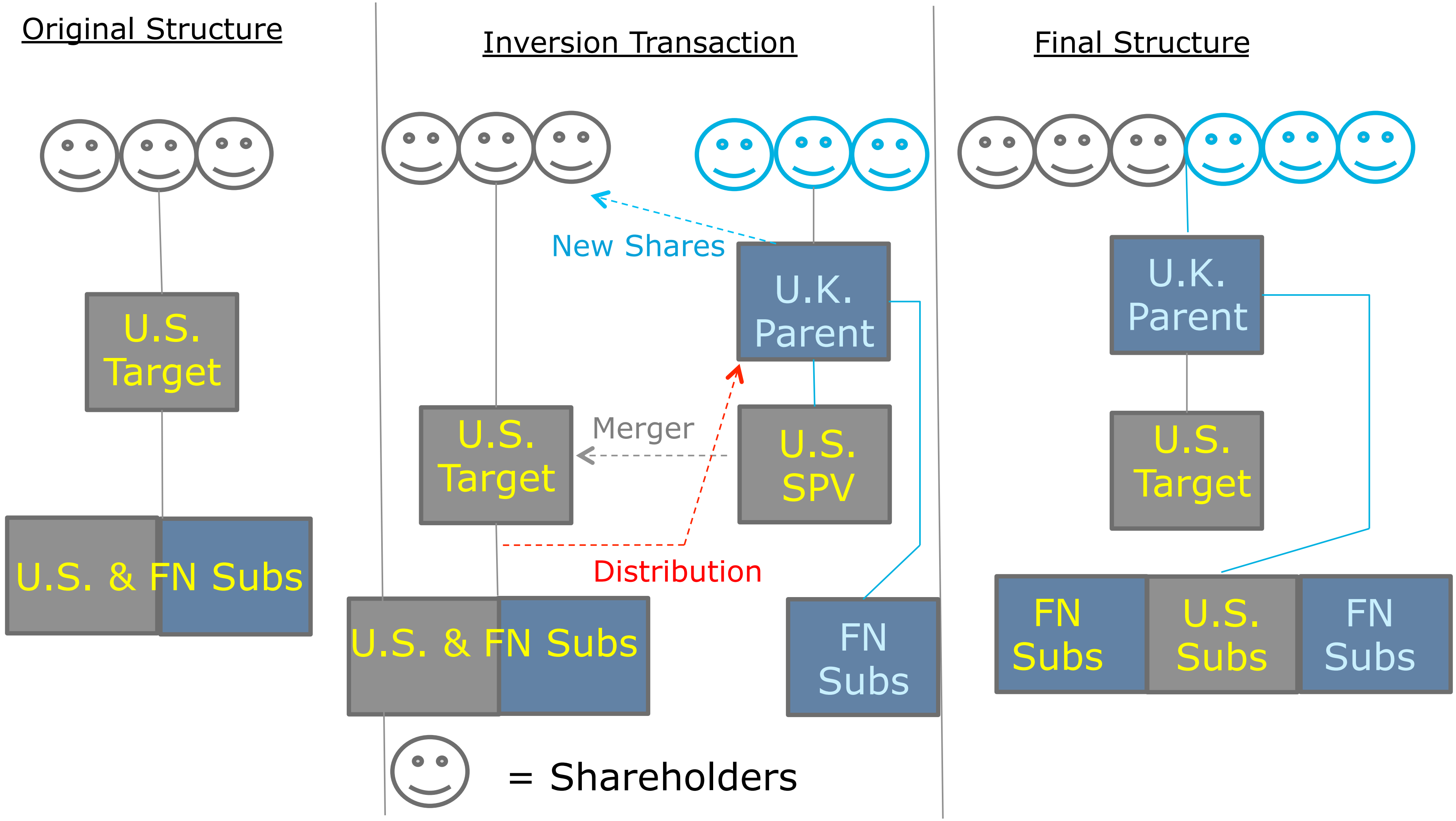



Home Country Tax Rate

- 0% to 5% on dividends from Fn OPCO and IP Boxco, depending on the terms of the participation exemption

# WHAT ARE THEY

# Typical Inversion Transaction



# ANTI-INVERSION LEGISLATION

SECTION 7874

# Code § 7874

- Inversion defined:
  - A foreign corporation acquires substantially all of the properties of a domestic target,
  - After the acquisition, at least 60% of the stock of the foreign corporation is owned by the former shareholders of the target, and
  - After the acquisition, the foreign acquiror does not have "substantial business activities" in the jurisdiction of the foreign acquiror.
- The inversion rules also apply to the acquisition of substantially all the assets of a partnership, if the partners of the target end up meeting the ownership test in the acquisition entity.

# Code § 7874

- Effect of inversion:
  - If the tests for an inversion are met, the tax effect will depend on the percentage of the acquiring foreign entity that is owned by the former shareholder
    - The general rule is that, for a ten-year period, the domestic target will be subject to tax on its "inversion gain"
      - This is gain related to certain transfers and licenses of property owned by the target
      - This means that net operating losses and foreign tax credits cannot reduce the taxable gain or income
      - This is largely designed to prevent C.F.C.'s, I.P. and other assets out from under the domestic target
    - A different rule applies if after the acquisition, at least 80% of the stock of the foreign corporation is owned by the former shareholders. The target is treated as a domestic U.S. corporation for all purposes of the Code. There is no inversion gain if the 80% threshold is attained.

# Code § 7874

- Rep. Levin proposes bill on certain aspects of Code §7874, with a retroactive effective date of May 8th
  - Thresholds reduced
    - The outbound transaction would be an inversion if continuous ownership of the newly inverted company by former shareholders or partners exceeds 50%
    - A merged company would be treated as domestic if management and control of the merged company remains in the U.S. and if 25% of its employees, employee compensation, income, or assets are located or derived in the U.S.
  - Earnings stripping rules of Code § 163(j) would be modified by:
    - Repealing the safe harbor debt-to-equity ratio (currently 1:5-1:0),
    - Reducing the permitted net interest expense to no more than 25% (from 50%) of the entity's adjusted taxable income (essentially E.B.I.T.D.A.), and
    - Limiting the carryforward of excess interest to five years from the current unlimited carryforward period.
  - Investment in taxable investment in U.S. property rules expanded
    - Accumulated earnings lent by C.F.C.'s to non-C.F.C. foreign affiliates where the latter use the funds to make investments into the U.S. without incurring tax at the shareholder level

# RECENT TREASURY ACTION

## NOTICE 2014-52

# Notice 2014-52

- The basic premise of §7874 is that if too much equity is retained by the former owners, the inversion rules should apply
- Over the course of this year, the market has focused on strategic mergers with a foreign entity of relatively comparable size in order to avoid inversion status
- Much of the planning involves
  - Shrinking the U.S. entity through disposition of assets
  - Stuffing the foreign entity with cash or marketable securities
  - Considering transactions with cash box companies that already have cash on hand prior to the transaction

# Notice 2014-52

- The anti-stuffing rules and anti-shrinking rules will be toughened in regulations
  - If 50% of the foreign party's assets are passive, a proportionate amount of the shares of the foreign acquiring corporation will be excluded from the denominator of the ownership fraction
  - Operating assets acquired by the acquiror in return for cash or other passive assets will themselves be treated as passive assets
  - Cash is considered a passive asset whether or not acquired with an intent to affect the percentages.
  - Non-ordinary course distributions by the domestic entity during the 36-month period ending on the acquisition date will be disregarded

# Notice 2014-52

- Opportunities for tax-free use of cash will be challenged
  - For purposes of §956, any obligation or stock of a foreign related person will be considered to be “U.S. Property” if acquired by a foreign entity that was a C.F.C. before its U.S. shareholder expatriated
  - Certain transfers to an expatriated foreign subsidiary will be treated as dividend distributions to the former U.S. shareholder of the subsidiary
  - Certain toll charges based on Code §1248 will be triggered on an accelerated basis under §367(b)
  - Use of intercompany sales of shares to reduce earnings and profits of an expatriated entity will be limited

# MARKET REACTION

## DEALS IN PLAY

# Status of Announced inversions As of 13 Oct 2014

- **Auxilium Pharmaceuticals Inc.** canceled agreement to buy Canadian rival QLT Inc and redomicile to Canada. The target will be acquired by Irish-domiciled Endo International.
- **Salix Pharmaceuticals Ltd.** called off an Irish inversion involving an acquisition of part of Italy's Cosmo Pharmaceuticals SpA.
- **AbbVie Inc.**, in pharma, agreed to buy Dublin-based Shire Plc and adopt a UK tax residency – transaction expected to close this year
- **Applied Materials Inc.**, the chipmaker, has agreed to buy smaller Japanese rival Tokyo Electron Ltd. – transaction expected to close this year; the new entity, Eteris, is expected to be incorporated in the Netherlands.
- **Burger King Worldwide Inc.** continues to proceed as planned to acquire Canadian coffee and doughnut seller Tim Hortons Inc. and to relocate to Canada.
- **C&J Energy Services Inc.**, the oilfield company, agreed to redomicile to Bermuda via a deal with Nabors Industries Ltd. – transaction expected to close this year.
- **Chiquita Brands International Inc.**, the food group, has agreed to combine with Ireland's Fyffes Plc. EU regulators have cleared transaction, but Cutrale and Safra Group have expressed interest in a joint takeover of Chiquita – business transaction still in play.
- **Medtronic Inc.**, the medical technology company, is working to close a deal with Ireland's Covidien Plc –transaction expected to close on or after year end. **N.B.** – Medtronic will use $16 billion in debt rather than cash held overseas.
- **Mylan Inc.**, in pharma, agreed to buy a piece of Abbott Laboratories' non-U.S. business, with the new company's tax domicile in the Netherlands – business transaction may still be in play.

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