accountingTODAY

**March 3, 2016** **UMV: 137,748**

# The Attraction of Inversion

***Despite government disapproval, corporate inversions still have fans***

BY ROGER RUSSELL

Corporate inversions, the recently controversial corporate tax maneuver in which a U.S.-based multinational group restructures itself so that the U.S. parent of the group is replaced by a foreign corporation — typically in a low-tax jurisdiction — allow companies to reduce their overall level of worldwide taxation.

A company that inverts continues to pay the U.S. corporate rate on profits earned through U.S. operations, and foreign profits brought back to the U.S. will get taxed by the U.S. However, the profits earned abroad escape being taxed by the U.S.

“Most of the major developed economies use a territorial system, which means that earnings are only taxed in the country in which they are earned,” said Dave Kautter, partner-in-charge of Washington National Tax Office at Top 5 Firm RSM US. “The U.S. is virtually the only major developed economy that uses the worldwide system. Since the competition for U.S. companies are headquartered in the major developed economies, U.S. companies find themselves at a competitive disadvantage to their foreign-headquartered competitors. That’s the primary reason for corporate inversions.”

“About 51 U.S. companies have reincorporated in low-tax countries since 1982, despite a code section [Sec. 7874] and regulations designed to limit it,” observed Selva Ozelli, an international tax attorney and CPA.

**STILL ATTRACTIVE**

Although the Treasury Department has issued guidance intended to make these inversion deals more difficult, transactions are continuing to be structured in ways that do not trigger those rules.

“The Treasury guidance consisted of two notices issued in September 2014 and November 2015,” according to Andrew Velarde, senior legal reporter at Tax Analysts. “The notices seek to limit inversions both by making them harder to successfully pull off, as well as by limiting the benefits available to companies that invert,” he said. “The rules are applied to inversions that fall between the 60 percent and 80 percent ownership threshold.”

If the ownership interest in the foreign corporation is over 80 percent, it’s the “kiss of death,” Velarde said. “The foreign company will still be treated as a U.S. company. Most of the rules have to do with inversions where the ownership interest falls between 60 percent and 80 percent, by limiting their ability to access offshore cash.”

There are trillions of dollars in offshore cash that would be taxed at U.S. rates if it was brought back, he explained. “If a company successfully inverts, it will have access to it. The rules attempt to limit the availability of tax-free access to offshore cash. Companies may now be trying to get below the 60 percent threshold, because the new rules don’t apply in that case,” he said.

Another advantage to inversions is earnings stripping, in which a company makes an inter-company loan from the foreign company to the U.S. entity and the U.S. entity has debt payments that are deductible and that reduce U.S. taxable income. “That has yet to be addressed,” Velarde noted. “In both notices, Treasury said they are considering earnings-stripping guidance. Some think that was put in as a scare tactic, while others think it might still be actually coming.”

**INVERSION ATTRACTION**

Despite the new rules, the benefits are real —and they’re still available, Velarde observed. “Proponents of corporate tax reform worry that targeting inversions without comprehensive tax reform is making it more likely for actual foreign company takeovers of U.S. companies.”

**“The rules have placed all kinds of hurdles in the way of accomplishing an inversion, but we all know where there’s a will there’s a way,” said Alan Lips, a director at Miami-based international tax and accounting firm Gerson Preston. “Because of the high corporate tax rate in the U.S., so many companies are looking for ways to lower their tax rate. It’s not the sole reason, but it is part of the reason for inversions. When they can move jobs offshore they save money at the same time, so there’s a double negative impact for the U.S. economy — losing jobs and losing tax dollars. For big public companies, if they can save significant dollars on both the payroll and the tax side, ultimately the profits will be higher and it will drive the stock price up. That’s a clear motivation for them to consider an inversion.”**

**“If there’s the opportunity to do an inversion, and enough dollars involved on the savings side, then these multinational companies will explore every possibility to get it done and fall within the new requirements,” he said. Part of the issue is that the rules have not yet been converted into regulations, according to Lips. “They’re not following up on the ultimate side. There needs to be clear rules as to what you can and cannot do. The regulations, when they come out, might take a harsher tone than the notices themselves.”**

**“But there’s more to it than just tax advantages,” he said. “From a business-decision perspective, it has to make sense. If it helps make the business more efficient and more profitable, then the possibility of an inversion will be a consideration.”**

The acquiring foreign corporation must have substantial business activities in its claimed home country for the inversion to be successful, noted Jeff Rubinger, a partner at Bilzin Sumberg. “The Treasury has made it more difficult to satisfy the substantial business activities test,” he said. “Now, the parent foreign company has to have at least 25 percent of its employees in the country of incorporation ... . If it's a true multinational with subsidiaries around the world, it's very difficult to meet the substantial business activity test because it's unlikely that they'll have 25 percent of their worldwide employees in one country. That's one of the ways they've made it more difficult."

"The biggest benefit [to a successful inversion] is that after the transaction you have a foreign parent," he said. "Before, when you repatriated cash you had to bring the money back to a U.S. parent and be taxed at 35 percent as a dividend. Now you can bring it back to the foreign parent without triggering tax, so the money is not trapped offshore."

**A CLOSING DOOR**

The tightening of the rules on inversions may be part of the impetus for companies now considering the strategy, Rubinger said: "They may be concerned that the rules will be made even more difficult so this might be their last chance to do something. It's possible that the 80 percent test could be made a 50 percent test, which would obviously be more stringent. No one knows what will happen, but people are concerned that the rules will be changed to make it more difficult."