M&A Update

Treasury Announces New Anti-Inversion Rules

September 23, 2014

On September 22, 2014, the Treasury Department announced its intent to issue new regulations that will reduce the tax benefits available after an inversion and may make it more difficult for some U.S. companies to invert (the "Notice"). The Notice does not require congressional action and applies immediately to all inversions completed after September 21, 2014.

Overview

1. The Notice prevents inverted companies from accessing their foreign subsidiaries' earnings while deferring U.S. tax through "hopscotch loans."

   - U.S. multinationals typically defer tax on foreign profits of their controlled foreign corporations ("CFCs") until they are repatriated to the U.S. as dividends or as loans to U.S. companies that are treated as deemed dividends.
   - To access foreign profits without U.S. tax, inverted companies may cause their foreign subsidiaries to make a hopscotch loan to the group's new foreign parent or its foreign subsidiary.
   - The Notice removes the benefits of hopscotch loans made within 10 years after an inversion by treating the loans as deemed dividends to the inverted U.S. parent.

2. The Notice prevents inverted companies from "de-controlling" their foreign subsidiaries to access their earnings tax-free.

   - After an inversion, some U.S. multinationals have accessed the earnings of their CFCs without U.S. tax by selling enough stock of their CFCs to the foreign parent to remove them from the U.S. tax net.
   - The Notice removes the benefits of this de-controlling strategy by treating the U.S. multinational as continuing to own all of the CFC's stock transferred within 10 years after an inversion.
   - The Notice also eliminates the ability of the group's new foreign parent to repatriate earnings tax-free by selling the former U.S. parent's stock to its CFC.

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3. The Notice makes it more difficult for some U.S. companies to invert.

    - After an inversion, the new foreign parent corporation will be treated as a U.S. corporation for tax purposes unless the inverted company's shareholders own less than 80% of the foreign parent's stock ("80% test").
    - The Notice prevents a U.S. company from paying a large dividend within three years before an inversion in order to reduce its value and enable it to satisfy the 80% test.
    - The Notice prevents a U.S. company from inverting a portion of its operations by transferring assets to a new foreign corporation and then distributing the new foreign corporation to its shareholders.
    - The Notice also precludes the use of a foreign company that was distributed out of a larger foreign group as a merger partner for an inverted U.S. company.
    - Finally, the Notice disregards certain passive assets that a foreign merger partner does not use in its daily business in calculating the foreign parent's value for purposes of the 80% test.

Observations

The Notice does not otherwise limit an inverted company's interest deductions on related party debt, which Sen. Charles Schumer (D-NY) referred to as "the number one incentive driving the wave of inversions we've seen in recent months." Treasury continues to consider potential revisions to these rules.

Takeaways

While the Notice will present challenges for some U.S. companies seeking to invert, most companies should be able to navigate the Notice and complete a successful inversion with proper planning.

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