On Sept. 22, 2014, the U.S. Department of the Treasury defined what a corporate tax inversion is and how it relates to §§ 304(b)(5)(B), 367, 956(e), 7701(l), and 7874 of the U.S. Tax Code.

In light of the various major companies using tax inversion and its attention in the media, this is an issue that both in-house counsel and outside counsel should not overlook.

“A corporate inversion is a transaction in which a U.S.-based multinational restructures so that the U.S. parent is replaced by a foreign parent, in order to avoid U.S. taxes. Current law subjects inversions that appear to be based primarily on tax considerations to certain potentially adverse tax consequences, but it has become clear by the growing pace of these transactions that for many corporations, these consequences are acceptable in light of the potential benefits.”¹ The negative consequences of these types of events come into play when two criteria are met:

1. “Less than 25 percent of the new multinational entity’s business activity is in the home country of the new foreign parent, and
2. The shareholders of the old U.S. parent end up owning at least 60 percent of the shares of the new foreign parent.”²

If these two prongs are met, then the analysis goes further to see what percentage of the U.S. parent company's shareholders have a stake. If that ownership percentage is 80 percent or more, then the newly formed foreign company is given the status of a U.S. company, despite the foreign address. Hence, the tax benefits are not realized. The public policy behind this is that the U.S. government believes that authentic cross-border mergers can stimulate both the United States and the foreign country by stimulating foreign investment. Moving a U.S. corporation to another country just to avoid paying higher taxes is not considered an authentic or genuine reason.³ In these instances, the tax advantages are lost.

One of the Internal Revenue Service (IRS) provisions impacted is 26 U.S.C. § 304—Redemption Through Use of Related Corporations.⁴ This particular portion of the U.S. Code addresses the treatment of certain stock purchases in relation to acquisitions by either the parent or a subsidiary corporation and the special rules for dividends and property treatment. Specifically, §304(f)(A) addresses acquisitions by foreign corporations, which include the definitions of a U.S. shareholder, while §304(5)(B)(i) deals with acquiring a foreign corporation and the tax implications that flow.

Why should both in-house and outside counsel be concerned with the new guidance? Several major companies have brought this issue to the forefront, including Burger King and Walgreens. Most of this type of information is found on a Form S-4 and a Form 8-K, which are filed with the U.S. Securities and Exchange Commission. A Form S-4 is a registration statement and is required under the U.S. Securities Act of 1933. A company files this type of form in connection with a public offering. This form may be used for registration under the Securities Act of 1933 (Securities Act) of securities to be issued (1) in a transaction of the type specified in paragraph (a) of Rule 145 (§ 230.145 of this chapter); (2) in a merger in which the applicable state law would not require the solicitation of the votes or consents of all of the security holders of the company being acquired; (3) in an exchange offer for securities of the issuer or other entity; (4) in a public reoffering or sale of any such securities acquired pursuant to this registration statement;
And, when a company engages in tax inversion, it is more or less merging and reorganizing with a lot of changes occurring in terms of its stock. The securities laws also require that companies give their shareholders a 20-day notice before a meeting or vote on this type of transaction.

A Form 8-K is used to disclose material events or transactions. Hence, in addition to press releases, analyst reports, and news items, SEC filings should not be overlooked by counsel.

On Sept. 16, 2014, Walgreens announced “that Walgreens Boots Alliance, Inc., the anticipated new holding company for the combined Walgreens and Alliance Boots enterprise, filed a Registration Statement on Form S-4 with the Securities and Exchange Commission (SEC) containing a preliminary proxy statement/prospectus related to Walgreens acquisition of the remaining 55 percent of Alliance Boots GmbH that the company doesn’t currently own and the reorganization of Walgreens into a holding company structure (the ‘Registration Statement’).” Alliance Boots GmbH is a Swiss company and Walgreens is a U.S.-based company. Switzerland taxes corporations differently than its U.S. counterpart. In order to reduce its tax liability, Walgreens planned on relabeling itself as a Swiss company—that is until the Treasury Guidance was issued.

Before September 22, 2014, there was:

[No bright-line legal distinction between a tax inversion and any other kind of international corporate merger. But in a broad qualitative sense, the difference is that in a pure tax inversion almost nothing changes on the ground.]

Contrast this with, say, the takeover of Anheuser-Busch (makers of Budweiser) by the Belgian company Inbev in 2008. The United States is obviously a much larger country than Belgium, so the new merged company AB Inbev sells more beer in the USA than in Belgium. But the company is Belgian, not just as a tax matter but in terms of the physical location of its corporate headquarters in Leuven. And in terms of personnel, the CEO of AB Inbev is the guy who was CEO of Inbev before the merger.

A tax inversion would be something like a large American brewery buying a small Belgian one, keeping its old American CEO and Midwestern corporate headquarters, but declaring that it’s now a Belgian company.

What distinguishes a tax inversion from another type of merger is the intent behind the merger. If the primary intent is discerned to be a lower tax rate instead of capitalizing on operations or brand recognition, then tax inversion applies and the Treasury’s factors come into play. If the primary purpose is not lowering taxes, then the merger is permissible.

The change in the U.S. government’s stance is significant. And, with business being global, these types of mergers and the intent behind them need to be fully fleshed out by both internal and external counsel before the transaction and filings occur. Planning ahead and evaluating the reasoning behind the merger can alleviate a major headache later.

Endnotes
2Id. Indicating that these provisions applied to any transaction executed on or after Sept. 22, 2014.
3Id.
6Id.
7See Securities Exchange Act of 1934, §§ 13(e), 14(d) and 14(e).
9See news.walgreens.com/article_display.cfm?article_id=5898.