April, 2015

Sharpened Blades: The United States Government’s Aggressive Attempt To Close The “Unpatriotic” Loophole Known As Corporate Inversions

Lili Sowlati

Available at: https://works.bepress.com/bocconi_legal_papers/54/
SHARPENED BLADES: THE UNITED STATES GOVERNMENT’S AGGRESSIVE ATTEMPT TO CLOSE THE “UNPATRIOTIC” LOOPHOLE KNOWN AS CORPORATE INVERSIONS

Lili Sowlati
SHARPENED BLADES: THE UNITED STATES GOVERNMENT’S AGGRESSIVE ATTEMPT TO CLOSE THE “UNPATRIOTIC” LOOPHOLE KNOWN AS CORPORATE INVERSIONS

Lili Sowlati

TABLE OF CONTENTS

I. INTRODUCTION .................................................................................................................. 3
II. TAXATION OF CORPORATE ENTITIES .............................................................................. 5
   A. UNITED STATES CORPORATE TAXATION SYSTEM .................................................... 5
   B. FOREIGN CORPORATE TAXATION SYSTEM .............................................................. 5
III. HISTORY OF UNITED STATES CORPORATE INVERSIONS .......................................... 6
   A. BENEFITS OF PARTAKING IN A CORPORATE INVERSION ...................................... 7
   B. INTERNAL REVENUE CODE SECTION 7874 .............................................................. 8
IV. 2014 LEGISLATION ........................................................................................................... 10
   A. STOP CORPORATE INVERSIONS ACT OF 2014 ...................................................... 11
   B. IRS NOTICE 2014-52 ................................................................................................. 13
V. 2014 LEGISLATION: EFFECT ON PENDING AND FUTURE CORPORATE INVERSIONS ...... 15
   A. EFFECT ON PENDING INVERSIONS: SHIRE, PLC’S ACQUISITION OF ABBVIE, INC. .... 16
   B. EFFECT ON PENDING INVERSIONS: MYLAN, INC. AND ABBOTT LABORATORIES ........ 17
   C. EFFECT ON FUTURE INVERSIONS ............................................................................ 18
VI. ADDITIONAL SOLUTIONS .................................................................................................. 19
   A. COMPREHENSIVE UNITED STATES CORPORATE TAX REFORM .............................. 19
   B. FAVORABLE INTERIM TAX RULES: INCREASE FOREIGN TAX CREDITS ..................... 20
   C. TERRITORIAL SYSTEM OF TAXATION .................................................................... 21
   D. LOWER CORPORATE TAX RATE .............................................................................. 21
VII. CONCLUSION .................................................................................................................. 22
I. INTRODUCTION

The United States is often referenced as the world’s «leading global trader».¹ Therefore, it comes as no surprise that the United States’ globalized economy allows for it to maintain the title as «the world’s largest national economy».² As the world’s leading global trader, many American companies have sales and earn profits from conducting business in foreign countries.³ Unfortunately, globalization has put many American multinational companies at odds with the United States worldwide system of taxation, and subsequently, it has been one of the primary reasons for the increase in United States corporate inversions throughout the past decade.

A corporate inversion occurs when a United States multinational company renounces its United States citizenship by «relocating its company headquarters to a foreign country with a lower corporate tax rate.»⁴ The relocation may take place in one of two ways: (1) through the merger and acquisition of a United States company by a corporation domiciled in the desired foreign country, or (2) simply by moving a United States company's domicile from a place within the United States to a foreign country.⁵ The focus of this article will be on the most prevalent kind of United States corporate inversions, those that take place through the merger and acquisition of a United States corporation.⁶ As a result of the company’s relocation, the company will declare the foreign country its new domicile, and in turn, the company will effectively become a «foreign corporation» for United States tax purposes.⁷ Following this declaration, the former United States company will no longer be subject to the worldwide system of taxation that applies to United States domestic corporations, but rather, it will be required to pay United States corporate taxes based on its new characterization as a foreign corporation.⁸ As a foreign corporation, the company will generally only be required to pay United States corporate taxes on income earned from sources within the United States.⁹

² Id.
³ Id.
⁵ Id.
⁸ Id.
⁹ Id.
According to the Congressional Research Service, «seventy-six corporate inversions have taken place in the United States since 1983».10 “Sixty two percent of these corporate inversions have taken place in the last decade.”11 The sudden increase in United States corporate inversions can be credited to the ever-expanding globalization of the American economy and the unfavorable treatment of domestic corporations under the United States corporate taxation system. Due to the sudden increase in the rate of United States corporate inversions and billions of dollars lost in tax revenues, American politicians and government officials have combined forces and sharpened their «blades» by introducing the Stop Corporate Inversions Act of 2014 and (Internal Revenue Service) IRS Notice 2014-52, in order to close the glaring, «unpatriotic loophole» that allows for corporate inversions to take place.12 If approved, the Stop Corporate Inversions Act of 2014 would amend the Internal Revenue Code to treat «all foreign corporations that acquire properties of a United States corporation or partnership after May 8, 2014, as an inverted corporation subject to United States domestic corporate taxation, if after such acquisition, the inverted corporation (1) holds more than fifty percent (50%) of the stock of the merged entity, or (2) the management or control of the merged entity occurs primarily within the United States, and the merged entity has significant domestic business activities».13 Similar to the Stop Corporate Inversions Act of 2014, IRS Notice 2014-52 immediately introduces new rules that disregard the structure of common corporate inversion transactions, thereby making it more difficult for a United States corporation to partake in a corporate inversion and benefit from the inversion for tax purposes.14

This article will first examine the taxation of corporate entities in the United States and foreign countries. Next, it will review the history of corporate inversions in the United States and the various benefits afforded to inverted companies under current United States tax laws. Then, this article will analyze the effect of the newly introduced Stop Corporate Inversions Act of 2014, as well as the effect of IRS Notice 2014-52 on pending and future corporate inversions. Lastly, this article will attempt to provide additional viable solutions to the United States corporate inversion problem.

11 Id.
II. TAXATION OF CORPORATE ENTITIES

To fully comprehend the business purpose behind United States corporate inversions, one must compare the corporate taxation system available in the United States to that of other foreign countries, in order to identify the significant tax advantages currently available to foreign corporations incorporated outside of the United States.

A. United States Corporate Taxation System

In the United States, a corporation is taxed depending on its classification as either a «domestic» or «foreign» corporation.\(^{15}\) Section 7701(a)(4) of the United States Code defines a domestic corporation as «a corporation created or organized in the United States or under the laws of the United States».\(^{16}\) Domestic corporations are «taxed on their worldwide income at the federal and state levels».\(^{17}\) This means that under the United States worldwide system of taxation, «all of a domestic corporation's income is subject to taxation in the United States, regardless of whether the income is earned from a source in the United States, or abroad».\(^{18}\) Therefore, unless foreign tax credits are extended to the United States domestic corporation, the domestic corporation that conducts business abroad is often subject to double taxation for one source of foreign income because it is required to pay corporate taxes in the foreign country it derives the foreign sourced income from, and, again, in the United States per the worldwide system of taxation that applies to United States domestic corporations.\(^{19}\)

B. Foreign Corporate Taxation Systems

A «foreign corporation» is defined as «a corporation that is not domestic».\(^{20}\) Generally, a foreign corporation is a corporation that is created and organized under the laws of another country, but which conducts business in the United States.\(^{21}\) This means that the «place of incorporation determines a corporation's classification for United States tax purposes, regardless of factors such as the location of a corporation's management activities, employees, officers, shareholders, assets, operations or sources of revenue».\(^{22}\) Contrary to United States domestic corporations, foreign corporations are only taxed by the United States on gross income

\(^{15}\) 26 U.S.C.A. § 7701 (West 2010).
\(^{16}\) 26 U.S.C.A. § 7701(a)(4) (West 2010).
\(^{17}\) 26 U.S.C.A. §11 (West 2010).
\(^{19}\) Id.
\(^{22}\) Sheppard, supra at 552.
produced from sources within the United States, and to the extent that such income meets the nexus and sourcing standards set forth by federal and state law.\textsuperscript{23}

It is important to note that unlike the United States’ worldwide system of taxation, many of the countries that are popular domiciles for United States multinational company corporate inversions have a territorial system of taxation in place, e.g. Ireland, United Kingdom, Luxembourg, etc. A territorial system of taxation «only taxes businesses on income earned within a country’s borders».\textsuperscript{24} This means that when a multinational company inverts to a new domicile with a territorial tax system in place, the multinational company will only be required to pay corporate taxes to the extent that the company’s income is earned from a source within the domiciled country.\textsuperscript{25} In effect, the territorial system of taxation allows for an inverted United States multinational company to achieve two things: (1) seek treatment as a «foreign corporation” under current United States corporate tax laws, and (2) avoid the payment of significant amounts of United States corporate taxes on foreign-earned income it otherwise would have had to pay under the United States worldwide system of taxation that applies to domestic corporation.\textsuperscript{26}

\section*{III. History of United States Corporate Inversions}

Profit margins determine the success of a company, and, because of this, maintaining or increasing profit margins heavily influence many company decisions. Therefore, when tax-planning experts informed large American multinational company executives that the Internal Revenue Code allowed for them to avoid the United States worldwide taxation while substantially reducing their foreign corporate tax liability, and, in turn, increasing their profit margins, many American multinational company executives made the prudent decision to invert. «McDermott International was the first United States company to engage in a corporate inversion when it made the decision to invert to a Panamanian corporation in 1983».\textsuperscript{27}

\begin{footnotes}
\item[25] Id.
\item[26] Id.
\end{footnotes}
A. Benefits of Partaking in a Corporate Inversion

Aside from minimizing an American multinational company’s foreign corporate tax liability, there are additional tax benefits conferred upon inverted United States multinational companies, but which are simultaneously detrimental to the United States economy and tax base and economy.28

For example, «all foreign countries have a lower corporate tax rate than the United States».29 Therefore, the corporate tax rate alone makes the inversion a popular choice amongst United States multinational company executives, since for instance, «Ireland, a popular domicile for inverted United States companies, has a statutory corporate tax rate of twelve point five percent (12.5%), which is substantially lower than the United States corporate tax rate of thirty five percent (35%), the highest in the world.»30 Therefore, despite the lower corporate tax rate allowing for additional tax savings for inverted United States multinational companies, a substantial amount of United States corporate tax revenue is lost as a result of the American multinational companies’ changed status as post-inversion foreign corporations.31

Further, as a result of the merger and acquisition that allowed for the United States corporation to partake in an inversion, the United States corporation may becomes a part of a foreign multinational group.32 Due to the United States corporation’s new membership into the multinational group, «the multinational group may choose to encumber the United States corporation with debt, and in turn, have the United States corporation make interest payments on the debt to the foreign multinational parent corporation».33 «Current United States tax laws allow for the United States corporation to deduct the interest payments from its United States taxable income, thereby reducing the amount of taxes the corporation owes to the United States government».34 This is another example of a benefit that is afforded to the inverted United States multinational company at the expense of the United States government, since the repetition of this process by inverted United States corporations results in a significant erosion of the United States corporate tax base, and thus creates a great going concern for the United States tax base economy.35

---

30 Id.
31 Id.
32 Id.
33 Id.
34 Id.
35 Id.
Similar to the interest expense deduction, another tax benefit exists for inverted United States corporations with excess cash on hand following a corporate inversion.\textsuperscript{36} For instance, «many United States multinational companies have large amounts of cash held by their foreign subsidiaries».\textsuperscript{37} «If the United States multinational company brings the cash back to the United States, either as a dividend or as a loan, current United States corporate tax laws impose a thirty five percent (35\%) tax on the repatriated cash, less any credits for foreign income taxes».\textsuperscript{38} However by inverting, «the foreign subsidiary of the United States multinational company can loan the excess cash to the new foreign parent corporation that was created in the corporate inversion».\textsuperscript{39} The loan does not trigger the imposition of any United States corporate tax, and as a result, the «trapped» cash is freed and may be distributed without any United States corporate tax consequences.\textsuperscript{40}

Therefore, as a result of the (1) United States’ substantial differentiation between domestic and foreign corporate taxation, (2) the favorable territorial taxation systems implemented in many foreign countries, (3) considerable differences in foreign corporate tax rates, and (4) additional tax benefits afforded to an inverted United States corporation, United States multinational executives are essentially incentivized by the current United States corporate taxation system to partake in corporate inversions.\textsuperscript{41}

\textbf{B. Internal Revenue Code section 7874}

«In the late 1990’s and the early 2000’s, a number of enormous United States corporations, such as Tyco International, and Cooper Industries, inverted and domiciled in countries such as Bermuda and the Cayman Islands».\textsuperscript{42} Following this new surge in United States corporate inversions, Congress added section 7874 to the Internal Revenue Code as part of its American Jobs Creation Act of 2004.\textsuperscript{43}

Section 7874(a)(2)(B) states that «after March 4, 2003, a foreign acquiring corporation is treated as a surrogate foreign corporation if according to a plan or a series of related

\textsuperscript{36} Id.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
\textsuperscript{42} Id.
\textsuperscript{43} «New Section 7874 Anti-Inversion Provision Has Broad Reach», \textit{Alston & Bird Llp Int'l Tax Advisory} (Mar. 15, 2005), http://www.alston.com/Files/Publication/d4996300-2bb5-4b3b-aa33-04f1e3114d39/Presentation/PublicationAttachment/49613a55-72d2-4efa-b371-e2cae4fefe1fa/Int%20Tax%20Adv%203-05.pdf.
transactions: (i) the foreign acquiring corporation completes the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation; (ii) after the acquisition, at least sixty percent (60%) of the stock of the foreign acquiring corporation is held by former shareholders of the domestic corporation, by reason of holding stock in the domestic corporation; and (iii) after the acquisition, the expanded affiliated group, which includes the foreign acquiring corporation, does not have substantial business activities in the foreign country, in which the foreign acquiring corporation is created or organized, when compared to the total business activities of the expanded affiliated group».44 Under this section, if after the merger, «the shareholders of the former United States company own at least sixty percent (60%), but less than eighty percent (80%) of the shares of the foreign acquiring corporation, the acquiring foreign corporation is subject to special rules that limit the use of net operating losses and other attributes such as foreign tax credits against income recognized by the inverted company by reason of the transfer of stock or other property, or the license of property during the ten-year period, beginning on the day property is first transferred in the inversion transaction».45

By implementing section 7874(a)(2)(B) into the Internal Revenue Code, Congress believed it had addressed the crux of its United States corporate inversion problem, since this was the first Internal Revenue Code section that attempted to regulate United States corporate inversions by directly regulating a key component of the corporate inversion transaction – United States stock ownership in the newly merged entity. This section directly affected the manner in which a corporate inversion could be effectively structured for United States corporate tax purposes because it installed maximum percentage thresholds on the inverted, former United States company shareholders’ ability to own stock in the newly merged entity, thus making it more difficult for an inverted company to take advantage of United States corporate tax benefits afforded to foreign corporations under the Internal Revenue Code.

At the same time, Congress further complemented its regulation of United States corporate inversions by implementing section 7874(b) into the Internal Revenue Code.46 Section 7874(b) states that, «a surrogate foreign corporation will be treated as a domestic corporation if it acquires at least eighty percent (80%) of the stock of a domestic corporation».47 Under this

47 Id.
section, any inverted United States company that meets the eighty percent (80%) stockholder
threshold is treated as a domestic corporation, thereby subjecting it to the United States
worldwide system of taxation that applies to domestic corporations, thus making the corporate
inversion completely ineffective for United States corporate tax purposes. Therefore, through
the imposition of maximum percentage threshold stock ownership requirements on the
inverted, former United States company’s shareholders, Congress effectively broadened the
definition of a «domestic corporation,» in order to make it more difficult for an inverted United
States company to qualify as a «foreign corporation» that receives significant United States
corporate tax benefits under the Internal Revenue Code, while still maintaining United States
ownership and control over the newly merged entity.

IV. 2014 Legislation

Following the introduction of Internal Revenue Code section 7874, there was a «dramatic
drop off in corporate inversions» in the United States. Corporate inversions «began to increase
again as tax practitioners developed techniques to deal with Internal Revenue Code section
7874, while the gap between the United States corporate income tax rate and the rates in other
countries widened». In the past couple of years, «a new wave of United States corporate
inversions have taken place with a number of United States corporations inverting to European
countries such as, Ireland, Luxembourg, and Switzerland, where the most favorable corporate
income tax havens are currently situated.» Since «January 2013, nineteen United States
companies have announced plans to invert overseas for tax purposes». «Fourteen of those
announced corporate inversions have taken place in 2014». Alarmed by the increasing number
of United States corporate inversions and the rapidly shrinking United States corporate tax
base, President Obama called upon United States government officials to introduce new «quick-

49 Id.
50 Id.
51 Id.
fix» legislation that will close the glaring «unpatriotic» loophole in the Internal Revenue Code, which allows for United States corporate inversions to take place.\textsuperscript{53}

\textit{A. Stop Corporate Inversions Act of 2014}

Responding to President Obama’s request, on May 20, 2014, Representative Sander Levin introduced the Stop Corporate Inversions Act of 2014 to the United States House of Representatives.\textsuperscript{54} On the same day, Senator Carl Levin introduced the S.2360 bill to the Senate.\textsuperscript{55} Substantively, both bills propose the same terms, which largely follow President Obama’s FY2015 budget proposal on solving the United States corporate inversion problem.\textsuperscript{56}

Before discussing the Stop Corporate Inversions Act of 2014, it is important to note that under current United States corporate tax laws, Internal Revenue Code section 7874 allows for an inverted United States corporation to either: (1) remain largely owned by its United States corporate shareholders (up to 60\% ownership), or (2) maintain the majority of its operations in the United States (up to 75\%), yet characterize itself as a «foreign corporation» for United States corporate tax purposes, and thus subject itself to more favorable United States corporate tax treatment as a foreign corporation in the United States.\textsuperscript{57}

Under the Stop Corporate Inversions Act of 2014 (hereinafter the “Act”), Representative Levin and Senator Levin propose for more stringent standards to be implemented in order to prevent United States corporations from inverting and capitalizing off the tax benefits afforded to inverted companies under current United States corporate tax laws.\textsuperscript{58} The Act advocates for such stringent standards to be implemented through an amendment of Internal Revenue Code section 7874.\textsuperscript{59} Specifically, the Act urges for such stringent standards to be carried out through a substantial increase in the acquiring company’s minimum threshold percentage of stock ownership in the merged entity from twenty percent (20\%), to fifty percent (50\%), so that the shareholders of the acquiring foreign company effectively own at least fifty percent (50\%) of the merged company’s stocks, in order for the inverted company to be characterized as a «foreign corporation» under Internal Revenue Code section 7874.\textsuperscript{60} In effect, by increasing the acquiring

\textsuperscript{54} H.R. 4679.
\textsuperscript{55} Stop Corporate Inversions Act of 2014, S. 2360, 113th Cong. (2014).
\textsuperscript{56} \textit{Id.}
\textsuperscript{57} § 7874.
\textsuperscript{58} H.R. 4679.
\textsuperscript{59} \textit{Id.}
\textsuperscript{60} \textit{See «Corporate Inversions», Ways And Means Comm. Democrats} (last visited Nov. 11, 2014).
foreign company’s threshold stock ownership requirement by thirty percent (30%), the Act makes it substantially more difficult for the inverted United States company to maintain ownership and control of the inverted company, while still taking advantage of the favorable corporate tax treatment afforded to foreign corporations under current United States corporate tax laws.\(^{61}\)

The inverted United States company’s difficulty in maintaining ownership and control over the merged entity is further amplified under the Act, which contends that «the inverted company will continue to be treated as a domestic United States corporation for tax purposes if management and control of the merged company remains in the United States, and either 25 percent (25%) of its employees, sales, or assets are located in the United States».\(^{62}\) By implementing this provision into Internal Revenue Code section 7874, the Act not only substantially expands the definition of a domestic corporation, but it also imposes a measurable (quantifiable) definition of a domestic corporation by identifying a threshold percentage of business activities that reflect factors such as the location of management, employees, sales, and assets, thus effectively minimizing an inverted United States company’s ability to argue for corporate tax treatment as a foreign corporation, while still maintaining the majority of its operations in the United States.\(^{63}\)

As suggested by President Obama, the legislative intent behind the Act is not long term, but a «quick-fix» solution, since the «United States cannot wait for general corporate tax reform to stop the bleeding» that is shrinking the United States corporate tax base.\(^{64}\) This point is strongly supported by Senator Levin, as evidenced by when he introduced the Act to the Senate stressing that, «if we continue to wait, we risk more American companies opting out of the United States corporate tax base by reincorporating in lower-tax foreign jurisdictions under the much more permissive current law applying to inversions».\(^{65}\) Similarly, the short-term intent of this Act is further evidenced by a provision within the Act itself, which «provides a two year moratorium on United States corporate inversions that do not meet the stricter tests in the Act» thus highlighting the Act’s short-term purpose as Congress considers a long-term solution to the United States corporate inversion problem as part of its general corporate tax reform.\(^{66}\)

\(^{61}\) Id.


\(^{63}\) Id.

\(^{64}\) Id.

\(^{65}\) Id.

\(^{66}\) Id.
B. IRS Notice 2014-52

Following Senator Levin and Representative Levin’s lead, the Internal Revenue Service (hereinafter “the IRS”) and the United States Department of the Treasury issued IRS Notice 2014-52 on September 22, 2014. IRS Notice 2014-52 (hereinafter “the Notice”) introduced a series of rules that aim to make partaking in pending and future corporate inversions nearly impossible under the current inversion scheme in which United States corporate inversion transactions are popularly structured. The rules from the Notice «apply to transactions that close on or after September 22, 2014, with no grandfathering provision for signed but not yet completed transactions».

The United States Department of the Treasury also used the Notice to announce its «intent to issue more regulations that would (i) increase the effective tax rate for foreign acquirers of United States corporations, by limiting the opportunities to achieve tax efficiencies in the course of integrating the operations, management, and financing of the businesses, and (ii) tighten the anti-inversion rules of Internal Revenue Code section 7874». This article examines the portion of the Notice that «focuses on those transactions that result in sixty to eighty percent (60% - 80%) United States corporate stock ownership in the merged company, which is perceived as abusive under Internal Revenue Code section 7874». The rationale behind the concentration on this section of the Notice is due to the fact that «most inverted companies rely on the less than eighty percent (80%) ownership test in Internal Revenue Code section 7874, to avoid continued treatment as a domestic corporation for United States corporate tax purposes». The Notice sets out to regulate Internal Revenue Code section 7874’s less than eighty percent (80%) ownership test by setting up controls that address two

---

68 Id.
well-known methods inverted companies use to structure their corporate inversion while staying within the parameters of the less than eighty percent (80%) ownership test.73

First, «the Notice states that an amount of stock proportionate to its percentage of passive assets will be excluded from the calculation of the ownership percentage if at least fifty percent (50%) of the foreign acquiring company’s assets are passive assets, including assets of the subsidiaries in its group».74 «Passive assets for this purpose include cash and marketable securities».75 In effect, this provision of the Notice prevents an acquiring corporation from falsely inflating its size for purposes of the ownership test by not permitting the acquiring corporation to include passive assets that are not actually part of the foreign acquiring company’s daily business activities in its size determination. In turn, since most United States corporate inversion transactions have been structured in such a way that the acquiring foreign company’s passive assets allow for the United States corporate inversion to pass Internal Revenue Code section 7874’s less than eighty percent ownership test, the Notice then makes it substantially more difficult for a smaller foreign company with inadequate active assets to acquire a large American multinational company while still maintaining foreign corporation status post-inversion.76 Ultimately, this provision of the Notice makes the commonly used inversion structure of having the foreign acquiring company «bulk up» with passive assets fruitless, and in turn, eliminates the inverted former United States company’s ability to take advantage of the tax benefits afforded to it as a foreign corporation by unjustifiably relying on passive assets to inflate the size of the acquiring foreign corporation for purposes of Internal Revenue Code section 7874’s less than eighty percent ownership test. 77

Second, like the popular foreign acquiring company’s «bulking up» inversion structure, many United States corporate inversions have also been structured in such a way that the United States corporation «skinny’s down» in anticipation of its acquisition, by issuing excessive dividends to its shareholders in order to satisfy Internal Revenue Code section 7874’s less than eighty percent ownership test.78 The Notice «attacks pre-inversion tailored transactions by disregarding pre-inversion extraordinary dividends made during the thirty-six (36) month period ending on the acquisition date».79 Extraordinary dividends are defined as «the excess of

73 Id.
74 Id.
75 Id.
77 Id.
78 Id.
79 Id.
all distributions during a taxable year over one hundred and ten percent (110%) of the average of such distributions during the thirty-six (36) months prior to such taxable year, and include distributions that are not treated as dividends». In addition, «a distribution includes any transfer of money or property to the United States corporation’s shareholders, to the extent that the money or property is provided directly or indirectly by the United States corporation». This provision complements the anti-passive asset «bulking up» rule, since it will «disregard large, pre-inversion dividend payments or distributions by United States corporations who desire to reduce their size in order to satisfy the less than eighty percent (80%) ownership test» imposed by Internal Revenue Code section 7874. Ultimately, the Notice’s disregarding provision for all distributions that take place thirty six (36) months prior to the acquisition makes it incredibly difficult for a United States company to satisfy the less than eighty percent (80%) ownership test without subjecting itself to treatment as a domestic corporation, thus making the commonly used «skinny down» corporate inversion structure largely ineffective for United States corporate tax purposes.

V. 2014 Legislation: Effect on Pending and Future Corporate Inversions

Assuming Congress passes the Act, the effect of the Act on pending and future corporate inversions will only be seen through the passage of time. However, if the current provisions of the Act are implemented into law, it is likely that the increased requirement of fifty percent (50%) foreign stock ownership in the merged entity will serve as a temporary solution to the American corporate inversion problem by making it more challenging for United States companies to invert and maintain management, control, and operations within the United States, while simultaneously maintaining a post-inversion foreign corporation status.

Further, without regard to the provisions of the Act, the Notice’s introduction on September 22, 2014 sparked many reactions across the media, government, and companies who were in the midst of pending United States corporate inversions. The first reaction to the Notice from a company in the midst of a pending United States corporate inversion was seen on October 20, 2014, when United States corporation, AbbVie, Inc., terminated its agreed upon anticipated acquisition of Shire, PLC, an Irish company. Similarly, a few days later on October 22, 2014,

---

80 Id.
81 Id.
82 Id.
83 Id.
84 H.R. 4679.
Mylan, Inc. and Abbott Laboratories adjusted the terms of their percentage stock ownership in an anticipated merger and acquisition, in order to guarantee that neither company could potentially be deemed to be in violation of the Notice and any future IRS notices that address United States corporate inversions.86

A. Effect on Pending Inversions: Shire, PLC’s acquisition of AbbVie, Inc.

AbbVie, Inc, is a United States biopharmaceutical company.87 In July of 2014, AbbVie, Inc. made headlines when it agreed to acquire Shire PLC, an Irish biopharmaceutical company, for $54.8 billion dollars.88 A driving force behind the merger and acquisition was so that post-acquisition, Abbvie, Inc. could relocate its headquarters from the United States to the United Kingdom, and thus take advantage of the territorial system of taxation available to corporations in the United Kingdom.89

Less than one month after the Notice rules were implemented by the United States Department of the Treasury, AbbVie, Inc. terminated its deal with Shire PLC, thereby «killing 2014’s largest agreed-upon merger, and giving the Obama administration a win «it has been fiercely fighting for».90 «As a result of the deal’s termination, AbbVie, Inc. agreed to pay Shire PLC the breakup fee of approximately $1.635 billion, which it said would be Shire PLC’s sole and exclusive remedy for all losses and damages in connection with the transaction».91 AbbVie, Inc. officials stated that, «a major factor in AbbVie, Inc’s decision to rethink its deal was possible future unfavorable rules regarding United States corporate inversions» for tax purposes.92 «Further, these officials reiterated that the new tax rules from the United States Department of the Treasury prompted AbbVie, Inc.’s board to withdraw its support for the deal because the recent changes “reinterpreted long-standing tax principles in a uniquely selective manner, which

85 Id.
91 Id.
92 Id.
were designed specifically to destroy the financial benefits of these types of transactions.” In essence, as a result of the Notice’s intricate rules that eliminate the financial benefits of partaking in a corporate inversion, the Notice single-handedly destroyed the largest proposed merger and acquisition of 2014, thereby effectively announcing and warning corporate America of its power and effectiveness to prevent pending and future United States corporate inversions.

B. Effect on Pending Inversions: Mylan, Inc. and Abbott Laboratories

Mylan, Inc. is a United States pharmaceuticals company. In July of 2014, Mylan, Inc. announced it had «entered into a definitive agreement with Abbott Laboratories, whereby Mylan would acquire Abbott's non-United States developed markets business,» and form a new entity in the Netherlands using the two companies’ combined assets. Following the creation of the new entity, Mylan, Inc. would be able to reincorporate in the Netherlands for tax purposes, and thus be subject to the favorable corporate tax laws available to Netherland corporations.

Approximately one month after the Notice was put into effect by the United States Department of the Treasury, Mylan, Inc. filed a regulatory filing with the Securities Exchange Commission announcing it had changed the terms to its acquisition of Abbott Laboratories assets. Under the renegotiated terms, «Mylan, Inc. said it would issue one hundred and ten (110) million shares in the newly formed company to Abbott Laboratories, which is five (5) million more shares than the original terms dictated». Therefore, under the renegotiated terms, «Mylan, Inc. shareholders will own seventy eight percent (78%) of the new company, instead of the proposed seventy nine percent (79%), and Abbott Laboratories will own twenty two percent (22%) of the new company, instead of the proposed twenty one percent (21%)». Although, neither company announced the rationale behind the sudden renegotiation in the terms of the agreement, multiple business and tax professionals cited the reasoning for the renegotiation «as a response to the Notice’s increased regulation of Internal Revenue Code section 7874’s less than eighty percent ownership test,» which effectively made it «harder for

93 Id.
94 Id.
98 Id.
99 Id.
100 Id.
companies to evade the 80-20 rule by slimming down on the United States side, or bulking up on the non-United States side».» Under the renegotiated terms, each company’s respective percentage stock ownership would «help ensure the old Mylan, Inc. shareholders would own less than eight percent (80%) of the new company,» and therefore allow Mylan, Inc. to benefit from the corporate inversion under Internal Revenue Code section 7874, while still complying with the Notice’s new provisions.102

C. Effect on Future Inversions

From the failure of the largest merger and acquisition of 2014, it is evident that there is substantial prevention power inherent in the Notice, which suggests the Notice contains a preventive function that makes it considerably more difficult for United States corporations to comply with the new corporate inversion laws, while simultaneously benefiting from the significant financial benefits that come along with partaking in a corporate inversion.103 Further, based on the Mylan, Inc. and Abbot Laboratories renegotiation, it is clear that the specific rules introduced by the Notice have captivated the attention of United States multinational company executives, so much as to prompt them to rethink the ways in which they will structure pending and future United States corporate inversion transactions.104 If the Act is to be enforced alongside the Notice and any future IRS notices that directly address United States corporate inversions, the combined effect of the legislation will certainly change the way future United States corporate inversion transactions are structured. This is because most common current corporate inversion structures are being invalidated by the Notice, and when combined with the stringent rules of the Act, the two laws would further prevent current inversion structured transactions from being implemented in order to avoid being held in violation of each or both laws.105

 Nonetheless, despite its current effectiveness, it is important to take note of the fact that the Notice, and when implemented, the Act, are no more than temporary solutions to the United States corporate inversion problem. They are temporary solutions because each law will cause many United States multinational company executives to return to the drawing board, as AbbVie, Inc. and Mylan, Inc. did, in order to rethink of new ways to structure their corporate

101 Id.
102 Id.
inversion transaction without violating the new United States corporate inversion laws. The reevaluation of the corporate inversion process will inevitably increase the cost and time it will take for a United States multinational company to make the decision to invert again. Thus, the United States government can only hope that the incentive of inverting considerably diminishes as result of the costliness of transacting a new, unaddressed corporate inversion plan. However because the extent of future planning expenses required to create new ways to bypass the Act and the Notice has not been determined yet, the United States government still runs a high risk of being unable to prevent United States corporate inversions if it later determined that the incentive to invert still remains significant for United States multinational companies. It is for this precise reason that a more progressive approach, such as comprehensive corporate tax reform, must be taken by the United States government in order to solve the United States corporate inversion problem. Until then, temporary solutions such as the Notice and the Act will only slow the process of United States corporate inversions, but they will not eliminate them, nor preserve the United States tax base and economy.

VI. ADDITIONAL SOLUTIONS

Following the dissolution of the merger and acquisition agreement with Shire PLC, AbbVie, Inc.’s Chairman and CEO, Richard Gonzalez, stated in reference to the Notice, «the unprecedented unilateral action by the United States Department of the Treasury may have destroyed the value in the AbbVie, Inc. transaction, but it does not resolve a critical issue American businesses face today as a result of the United States Tax Code being outdated». Gonzalez states that «investment in the United States is an area of critical importance, but the outdated United States Tax Code puts multinational United States based companies at a disadvantage to foreign competitors, and without comprehensive United States tax reform, increased competition to stimulate investment in the United economy» cannot be attained.106

A. Comprehensive United States Corporate Tax Reform

Echoing Gonzalez’ words, in order to permanently stop, United States corporate inversions, the United States government must adopt a more aggressive tax agenda, which ultimately results in comprehensive corporate tax reform to the United States Tax Code. Until then, legislation like the Act, and tightening regulations such as the Notice, will only be «quick-fix» answers that will never be adequate long-term solution to the United States corporate inversion

107 Id.
problem. Without comprehensive corporate tax reform, history will repeat itself, and it will only be a matter of time before highly skilled tax professionals come up with innovative corporate inversion techniques that will be capable of escaping the language of corporate inversion legislation such as, Internal Revenue Code section 7874, the Act, and the Notice, thus again result in the rapid depletion of the United States corporate tax base.

On the road to comprehensive corporate tax reform, the United States government should first depart from a regulatory scheme, and instead, move into a realm where it effects change in the corporate tax system by inducement. This means that instead of the United States government putting all of its efforts towards designing rules that deconstruct the manner in which common United States corporate inversion transactions are structured, the United States government should first look to understand the United States multinational companies’ reasons for partaking in a corporate inversion, and then based on this understanding, effectively groom the United States Tax Code through a comprehensive corporate tax reform, in order to become an attractive enough venue that does not offer compelling tax reasons for an American multinational company to invert to a foreign domicile.

B. Favorable Interim Tax Rules: Increase Foreign Tax Credits

Assuming the United States government adopts a comprehensive corporate tax reform plan, the United States government should look to introduce favorable interim rules that reflect future tax reform policies in order to prevent United States multinational companies from inverting during the planning tax reform period.

For instance, the United States government could increase the amount of foreign tax credits it makes available to American multinational companies. If the United States government chooses to increase the amount of foreign tax credits, while still maintaining a worldwide system of taxation, the foreign tax credit will equalize the amount of tax paid abroad by a United States multinational company, thereby potentially reducing a United States multinational company’s foreign corporate tax exposure enough to effectively eliminate the company from being subject to double taxation. In turn, this will temporarily lessen the multinational company’s foreign corporate tax liabilities while waiting for the comprehensive tax reform to be implemented in the United States. Ultimately, if the foreign tax credits offered by the United States are substantial enough during the interim period, meaning, the corporate tax savings are favorable enough to make a difference to the United States multinational company, the foreign tax credit would likely prevent a United States multinational company from inverting for tax purposes.
during the interim period, and thus maintain significant corporate tax revenues within the United States in the long run.

C. Territorial System of Taxation

As part of its comprehensive corporate tax reform plan, the United States government should transition into a territorial system of taxation. «Under a purely territorial regime, income that is earned in a foreign country, beyond the borders of the taxing nation, is not taxed». 108 In the past two years, Republicans have supported shifting the United States to a territorial tax system. 109 Under the Republican proposition, «foreign profits from a United States company would be taxed by the United States only when earned in very low rate jurisdictions (i.e., below fifteen percent (15%), or at a very low rate when brought back into the United States». 110 Like AbbVie, Inc.’s CEO proposed, «embracing this new territorial tax regime will enable domestic corporations operating abroad to be more competitive internationally, allow them to create more jobs in America, and therefore make them less susceptible to the pressures of inverting». 111 In turn, once the territorial system of taxation is implemented in the United States for a reasonable period of time, the new system would considerably boost the United States tax base and economy by keeping United States multinational companies in the United States, and potentially bringing back former-United States companies that inverted to avoid the worldwide system of taxation. 112

D. Lower Corporate Tax Rate

In contrast to the Republican proposed shift to a territorial system of taxation, «the Democratic tax reform plans have called for ending the deferral of United States taxation on foreign profits, while imposing a lower corporate tax rate that would offset taxes paid to foreign jurisdictions». 113 Ideally, as, part of its comprehensive corporate tax reform plan, the United States government should also reduce its corporate tax rate, so as to match that of favorable corporate inversion country domiciles. By lowering its corporate tax rate to match popular corporate inversion country domiciles, the United States government eliminates a main

108 Sheppard, supra at 567.
110 Id.
111 Id.
112 Id.
113 Id.
considerations that supports a United States multinational company’s decision to partake in a corporate inversion.

Alternatively, if the United States government is not open to such a substantial reduction in the United States corporate tax rate, it should look to set its corporate tax rate at the worldwide average, which is currently twenty three point five percent (23.5%).

For instance, if the United States government were to set its corporate tax rate to the current worldwide average, it would effectively lower the United States corporate tax rate by eleven point five percent (11.5%). Although it may appear that this reduction in the United States corporate tax rate would cause the United States government to lose substantial corporate tax revenue, when coupled with equalizing foreign tax credits, and/or a territorial system of taxation, as well other business expenses involved in planning for a corporate inversion, a cost-benefit analysis would likely incentivize many American multinational company executives considering a corporate inversion, to not invert, at least for tax purposes, and thus remain domiciled in the United States. Over the course of time, this new United States corporate tax scheme will (1) lessen the number of United States corporate inversions that take place for tax purposes, (2) generate ample tax revenue for the United States government, and (3) it will ultimately bolster the United States economy as a result of the decrease in the number of United States corporate inversions, and the increase in the number of newly created jobs that result from the United States corporation remaining domiciled or reestablished in the United States.

VII. CONCLUSION

In late 2014, heightened attention from the media, intense scrutiny by President Obama, and the United States government’s issuance of legislation directly targeting United States corporate inversions has slowed the wave of United States corporate inversions. Although the number of United States corporate inversions has decreased since the introduction of new legislation targeting common corporate inversion transactions, when looking back on the history of United States corporate inversions, the United States government should not interpret the recent decrease in United States corporate inversions as a sign that its United States corporate inversion problem has been addressed. These rules and legislations are simply temporary solutions to a long-term problem. Without comprehensive United States corporate tax reform, the United States multinational company executives cannot be mistaken as defeated, when they

---

are in fact having their trusted tax professionals sharpen their blades to innovate new techniques that look to escape the grasp of United States anti-corporate inversion legislation. Thus, as long as considerable tax incentives remain for inverted American multinational companies, while comprehensive United States corporate tax reform remains a distant consideration for future policymakers of America, then the United States government must continue to draft new legislation, in order to combat its ongoing corporate inversion problem.