X. The Recent Wave of Tax Inversions and Implications of the Corporate Income Tax

A. Introduction

"Tax inversions"—often referred to as "corporate inversions"—have been taking place at a greater frequency in the past few years.[1] Tax inversions are a method used by businesses to reincorporate in a foreign country to avoid paying U.S. corporate taxes, which are generally higher than those of other nations, such as Ireland, Canada, and the Netherlands.[2] In the United States, the federal government taxes corporate earnings at almost thirty-five percent.[3] The inversion's popularity, therefore, stems from its ability save the company money on taxes.[4] The high U.S. corporate tax rate has driven some companies to merge with international companies in order to take advantage of those international companies' home corporate tax rates.[5] When a corporation reincorporates in a foreign nation, a corporation is no longer "subject to U.S. worldwide taxation" and can prevent portions of its income from being taxed by the IRS.[6]

Tax inversions have become a concern for the U.S. government and are the subject of significant debate.[7] Inversions by large companies such as multinational corporations limit the flow of money going into the U.S. Treasury and may have a collateral impact on national tax rates.[8] As long as the corporate income tax stands at its

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[1] John W. Schoen, *Corporate 'inversions' are the latest ploy to upend the US tax code*, CNBC (July 24, 2014, 1:41 PM), http://www.cnbc.com/id/101864543#, *archived at* http://perma.cc/UXR2-FXLF.
[2] *Id.*; *See* Janet Novack & Liyan Chen, *Tax Dodgers Inc.*, FORBES, Sept. 29, 2014, at 18–19.
[3] *Developments in the Law—Drawing Lines Around Corporate Inversion*, 118 HARV. L. REV. 2270, 2276 (2005).
[4] Kevin Drawbaugh, *Corporate foreign tax moves have bedeviled U.S. for decades*, REUTERS (Aug. 18, 2014, 1:12 AM), http://www.reuters.com/article/2014/08/18/us-usa-tax-inversion-rules-idUSKBN0GI0B020140818, *archived at* http://perma.cc/5ABQ-NP7P.
[5] N. Gregory Mankiw, *How to Fix the Corporate Tax? Repeal It*, N.Y. TIMES, Aug. 24, 2014, at BU7.
[6] Orsolya Kun, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications*, 29 DEL. J. CORP. L. 313, 313 (2004).
[7] *Id.* at 314.
[8] Mankiw, *supra* note 5 (highlighting that individual taxpayers often have to compensate for the reduced tax base caused by corporate flight).

current rate, corporate executives will likely take advantage of tax inversions to increase shareholder profits.[9] Although the U.S. Treasury has proposed regulations that would make tax inversions more difficult or eliminate their widespread use,[10] the thirty-five percent tax rate on corporate income will continue to serve as an impetus to pursue tax inversions.[11]

This Article outlines the current trend of corporations undergoing tax inversions and the implications of the federal corporate income tax. Part B explores the factors influencing tax inversions, while Part C provides an overview of historical and current tax inversion trends. Finally, Part D discusses the trend's potential implications and various proposals to combat inversions.

B. The Factors Influencing Tax Inversions

Practitioners have described tax inversions as "an international corporation reincorporating in a different country, changing from a U.S. corporation to an offshore jurisdiction that is usually a tax haven and therefore potentially reducing tax liability."[12] There are three ways in which an inversion can occur: (1) "stock" inversions; (2) "asset" inversions; or (3) "drop-down" inversions combining both stock and asset inversions.[13] A stock—or share—inversion occurs when a foreign company obtains the stock of an existing U.S. company.[14] An asset inversion consists of a total restructuring that "replaces the former U.S. parent [corporation] with the new foreign parent corporation . . . ."[15] Drop-down inversions—or "combined inversions"—combine aspects of share and asset inversions by using an asset inversion deal structure, but proceed by transferring assets to the foreign company in exchange for stock of the company seeking reincorporation.[16]

Although corporate inversions are now commonplace transactions, the number of inverters has recently increased to the point

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[9] *Id.*
[10] I.R.S. Notice 2014-52, 2014-42 I.R.B. 712; Treas. News Release JL-2645 (Sept. 22, 2014).
[11] *See* Mankiw, *supra* note 5.
[12] Jon Weiner, *Corporate Inversions and Section 7874—Provisions, Predecessors, and Policies*, 24 PRAC. TAX LAW. 27, 27 (2010).
[13] *Id.*
[14] Kun, *supra* note 6, at 320.
[15] *Id.* at 322.
[16] *Id.* at 324–25.

that government regulators and lawmakers are debating courses of action to address the trend.[17] Inverting corporations have acknowledged that the principal rationale for a corporate inversion is to "remove . . . income from the ambit of U.S. worldwide taxation."[18] Companies seek these inversions because the United States taxes not only corporate income earned domestically, but also income earned abroad—known as "worldwide income."[19] In addition, U.S. corporations must pay taxes to the IRS at the *greater of* (1) the U.S. tax rate, and (2) the tax rate in the income-generating country.[20] As a result of this taxation structure, U.S. corporations operating overseas operate at a competitive disadvantage to their foreign-based counterparts, who often pay much lower rates.[21]

However, there are structures in place designed to alleviate the disadvantage of U.S. incorporation for companies conducting business overseas.[22] For example, under the "repatriation rule," a U.S. multinational company may postpone income tax payments by their non-U.S. subsidiaries until the income is "remitted to the U.S. as dividends or other income."[23] A corporation can avail itself of this rule by converting its foreign branches—whose earnings are "taxed on a current basis"—into incorporated subsidiaries by satisfying broad, easily-met "check-the-box regulations."[24] Accordingly, this repatriation rule leads to some undesirable side effects, including incentivizing companies to delay U.S. repatriation indefinitely.[25]

C. The History of Tax Inversions and the Current Trend

Corporate inversions have been occurring for over three decades and the U.S. government has been scrutinizing these

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[17] *See* Treas. News Release JL-2645, *supra* note 10; Stop Corporate Inversions Act of 2014, H.R. 4679, 113th Cong. (2014).
[18] Kun, *supra* note 6, at 330.
[19] Joshua Simpson, *Analyzing Corporate Inversions and Proposed Changes to the Repatriation Rule*, 68 NYU ANN. SURV. AM. L. 673, 679 (2013); *see* I.R.C. § § 11, 882 (2012).
[20] Simpson, *supra* note 19.
[21] *Id.* at 679–80 (describing how foreign corporations often operate under a "territorial" tax regime, which "only tax[es] the profits of domestic and foreign firms earned [within] their territories.").
[22] *Id.* at 680.
[23] *Id.*
[24] *Id.*
[25] *Id.* at 680–81, 714.

transactions since 1983.[26] In the past, there have been three inversion cycles, each defined by specific examples a corporate inversions representing specific transaction structures.[27] The first occurred in 1983 and is defined by the McDermott, Inc. transaction.[28] Another cycle occurred in 1994, with the Helen of Troy Corporation inversion being the prime example.[29] The third cycle occurred in 2001, with the Cooper Industries and Ingersoll-Rand PLC inversions.[30] Each of these cycles are not only defined by the specific structures of tax inversions, but by the counter-measures designed to discourage their use as well.[31]

The McDermott, Inc. large-scale restructuring was one of the first of its kind to gather considerable IRS attention.[32] The deal consisted of "remov[ing] non-taxed passive income from the United States' taxing jurisdiction" and was met with a congressional measure denying the benefits obtained by the transaction to future inverting corporations.[33] The mechanics of the McDermott, Inc. transaction consisted of a structural share inversion to a preexisting subsidiary that ultimately provided shareholders with cash and a stated savings of "$220 million . . . over five years."[34]

The Helen of Troy inversion, on the other hand, used a structure that would both (1) prevent shareholders from being subject to tax liability and (2) increase stockholder value by decreasing its corporate taxes after the reorganization.[35] The IRS combatted this inversion in the form of regulations that taxed profits obtained through inversion, and deterred companies from inverting at the outset.[36] The IRS taxed gains obtained through domestic-to-foreign share transfers when the domestic corporation retained ownership of at least fifty percent of the inverted foreign company.[37] Nonetheless, this inversion tax lost its restraining effect "as stock market prices fell and the market acceptance of inverted companies increased."[38] As entities considering

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[26] Drawbaugh, *supra* note 4.
[27] Weiner, *supra* note 12, at 28.
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] Kun, *supra* note 6, at 315–16.
[33] *Id.* at 316.
[34] Simpson, *supra* note 19, at 695–96.
[35] Kun, *supra* note 6, at 316.
[36] *Id.* at 318; *see* I.R.S. Notice 94-47, 1994-1 C.B. 356–57.
[37] Kun, *supra* note 6, at 316.
[38] *Id*. at 318.

inversions shifted focus onto the "[tax] base erosion benefits" of inverting, a new era of inversions took shape from 1998 through 2002.[39]

The Cooper Industries and Ingersoll-Rand inversions in 2001 culminated in the enactment of section 7874 of the tax code,[40] which designates rules relating to expatriated companies.[41] These inversions involved a transfer of U.S. income into Bermuda via three different foreign countries; ultimately, Ingersoll-Rand trimmed its tax receipts by circumventing a thirty percent tax imposed by the U.S. government on outbound income.[42] Although section 7874 prohibited "naked inversions"—a type of asset inversion—it did not prevent merger-based inversions.[43]

Tax inversions have recently become a fairly straightforward mechanism for trimming corporate tax liability.[44] Since 2010, deal volume for corporate merger inversions has increased exponentially.[45] The 2014 inversions amount to "about 55% of all inversion deals (in dollar value) since 1996."[46] In addition to the potential for lucrative investment banking fees for completing inversions, anxiety about a potential legislative or regulatory reaction have also likely influenced the growth of 2014 inversions.[47] A number of 2014 inversions have drawn the attention of the U.S. government and resulted in the Obama administration bringing the issue to Congress.[48] The U.S Treasury itself has recently taken measures to prevent corporate inversions by issuing a notice setting forth plans to combat corporate tax avoidance.[49] The notice outlined specific steps to "prevent inverted companies from

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[39] *Id.*
[40] I.R.C. § 7874 (2012).
[41] Simpson¸ *supra* note 19, at 697.
[42] Patrick Temple-West, *Ingersoll-Rand fights IRS 'treaty shopping' case in U.S. Tax Court*, REUTERS (Nov. 25, 2013, 3:58 PM), http://www.reuters.com/article/2013/11/25/usa-tax-litigation-idUSL2N0J42F420131125, *archived at* http://perma.cc/SGE9-VNEC.
[43] Thomas L. Hungerford, *Policy Responses to Corporate Inversions: Close the Barn Door Before the Horse Bolts*, 386 ECON. POL'Y INST. (EPI ISSUE BRIEF) 1, 4 (2014), *available at* http://www.epi.org/files/2014/corporate-inversions.pdf, *archived at* http://perma.cc/N7AV-3Y2P.
[44] Weiner, *supra* note 12, at 27.
[45] Novack & Chen, *supra* note 2.
[46] *Id.* at 18.
[47] *Id.*
[48] Schoen, *supra* note 1.
[49] Treas. News Release JL-2645, *supra* note 10.

accessing a foreign subsidiary's earnings while deferring U.S. tax . . . [and] restructuring a foreign subsidiary in order to access the subsidiary's earnings tax-free," among other measures.[50]

As a result of the planned U.S. Treasury action, some proposed tax inversions have fallen through due to the "unacceptable level of uncertainty [introduced] to the transaction."[51] For example, the recently proposed merger between AbbVie Inc. and Shire PLC failed as a result of the U.S. Treasury announcement.[52] The new U.S. Treasury guidelines have had their intended effect upon another proposed inversion involving Chiquita Brands International Inc. and Fyffes PLC, when the acquiror's stockholders vetoed the inversion.[53] Nonetheless, the notice has not been enough to deter some inverters, notably Medtronic Inc. and Covidien PLC.[54] In response to the recent wave of corporate inversions, the U.S. government has clearly attempted to impede its occurrence by attacking the popular aspects of recent deals, such as access to foreign income.[55]

D. Implications of the Recent Wave of Tax Inversions and the Corporate Income Tax

Economists have characterized the recent upsurge in tax inversions as a response to the high U.S. corporate income tax.[56] In addition to this effect, the tax rate has also had collateral implications on corporate behavior apart from encouraging inversions.[57] The high corporate tax rate has prompted companies to place their "assets and accumulated earnings" in foreign countries, counting on transferring

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[50] *Id.*

[51] AbbVie Inc., Current Report (Form 8-K), exh. 99.1 (Oct. 15, 2014); *accord* David Gelles, *Crackdown Is Said to Sink AbbVie Deal*, N.Y. TIMES, Oct. 16, 2014, at B1.

[52] Gelles, *supra* note 51.

[53] Maureen Farrell, *Chiquita-Fyffes Is Latest Inversion Deal to Be Called Off*, WALL ST. J. (Oct. 24, 2014, 12:14 PM), http://blogs.wsj.com/moneybeat/2014/10/24/chiquita-fyffes-is-latest-inversion-deal-to-be-called-off/.

[54] Joseph Walker & John Revill, *Medtronic Sticks With Its Tax Deal*, WALL ST. J., http://online.wsj.com/articles/medtronic-to-finance-covidien-deal-with-debt-1412345216 (last updated Oct. 3, 2014, 6:24 PM).

[55] John D. McKinnon & Damian Paletta, *U.S. Moves to Deter Firms Fleeing Taxes*, WALL ST. J., Sept. 23, 2014, at A1.

[56] Mankiw, *supra* note 5.

[57] *Id.*

that income back to the United States when a future Congress decides to reduce the corporate tax rate.[58] In effect, the actions of these companies have resulted in almost two trillion dollars held overseas, as opposed to being invested in the United States economy.[59] In addition to motivating other American conglomerates holding foreign earnings to decamp for the familiar offshore low-tax havens, the recent wave of inversions is depleting tax revenues accumulated by the U.S. Treasury.[60]

As a result of this inversion boom, U.S. Treasury has anticipated a possible loss of up to twenty billion dollars in tax revenue over the next ten years.[61] This potential loss of tax monies adversely impacts American citizens, who are forced into a dilemma—either contribute more of their income to taxes to compensate the corporate flight, or cut government provisions.[62] President Obama's administration, in response, has considered forcing companies that reincorporate abroad to be majority-foreign-owned, effectively making inversions much more onerous.[63] One economist has even suggested dismantling the corporate earnings tax system altogether.[64] Other suggested reforms include "replacing (or supplementing) the corporate income tax with a consumption tax . . . and changing from the current worldwide tax regime to a territorial system."[65]

A consumption tax would replace the current system with a tax rate equivalent to the country in which the corporation's "goods or services" are used.[66] Such a system would make avoiding higher taxes more difficult because "large consumer markets are unlikely to be tax havens and are likely to want to impose tax on foreign importers as well as on domestic sellers."[67] A change to a territorial system would tax corporations according to the territory they are located in, and effectively remove the need for corporate inversions by enabling U.S.

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[58] Schoen, *supra* note 1.
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] Mankiw, *supra* note 5.
[63] Schoen, *supra* note 1.
[64] Mankiw, *supra* note 5.
[65] *Drawing Lines Around Corporate Inversion*, *supra* note 3, at 2288.
[66] Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1670–71 (2000).
[67] *Id.* at 1671.

companies to "compete on a level playing field in foreign markets."[68] Ultimately, however, each avenue of reforming the tax code is met with opposition from business interest lobbyists keen on continuing to enjoy their present tax advantages.[69]

Tax inversions also have considerable effects upon the allocation of shareholder and director rights "by introducing a component of uncertainty and ambiguity in the corporate governance model."[70] This uncertainty occurs because of the realities of reincorporating in another country—when the holding company reincorporates, "the laws of that jurisdiction then govern the rights and obligations of the corporation."[71] The laws of the foreign country in which corporations reincorporate may have vague guidelines that are not as robust as United States state corporate law regimes.[72] Such ambiguity results in (1) weakening access to the courts, (2) reducing the ability of activist shareholders to check the power of wayward corporate boards and management, and (3) encouraging neglect of fiduciary duties.[73] The lack of information for shareholders also illuminates the fact that corporate executives may possess different motives for reincorporating than stockholders.[74] For instance, tax inversions may allow executives to obtain tax savings on their individual executive incentive plans that they might not have obtained otherwise—creating additional forces affecting the pursuit of tax inversion.[75]

E. Conclusion

So long as corporate executives maintain their fiduciary duty to shareholders, management will continue to consider using tax inversions if they result in value-creation for their shareholders.[76] In

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[68] Veronique de Rugy, *Quick-Fix Curbs on Corporate Inversions Mask the Real Problem*, 28 TAX NOTES INT'L 805, 808 (2002).
[69] Schoen, *supra* note 1.
[70] Kun, *supra* note 6, at 364.
[71] Hale E. Sheppard, *Fight or Flight of U.S.-Based Multinational Businesses: Analyzing the Causes for, Effects of, and Solutions to the Corporate Inversion Trend*, 23 N.W. J. INT'L L. & BUS. 551, 566 (2003).
[72] Kun, *supra* note 6, at 364 (lauding the "clarity and comprehensiveness of Delaware law.").
[73] *See id.*
[74] *Id.* at 366.
[75] *Id.*
[76] Mankiw, *supra* note 5.

addition, actors in a competitive marketplace will continue to invert to keep pace with multinationals that have already reincorporated.[77] The current wave of tax inversions has been influenced by several factors and unless Congress passes new legislation to amend the tax code, the trend is likely to continue if market influences remain relatively consistent.[78] Any legislation seeking to regulate the wave to tax inversions will have to strongly consider reform of the corporate income tax.[79] As it stands, the corporate income tax will continue to drive entities to pursue tax inversions in 2014's economy.[80] Therefore, any efforts by the government to discourage inversions or to regulate their use may best be implemented through reform of the relevant law governing corporate taxation.[81]

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[77] Kun, *supra* note 6, at 319.
[78] Hungerford, *supra* note 43, at 7–8.
[79] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-520, CORPORATE INCOME TAX: EFFECTIVE TAX RATES CAN DIFFER SIGNIFICANTLY FROM THE STATUTORY RATE 1 (2013).
[80] *See supra* notes 44–50 and accompanying text (describing the recent upward trend in inversions since 2010).
[81] *See* Hungerford, *supra* note 43, at 2.
[82] Student, Boston University School of Law (J.D. 2016).