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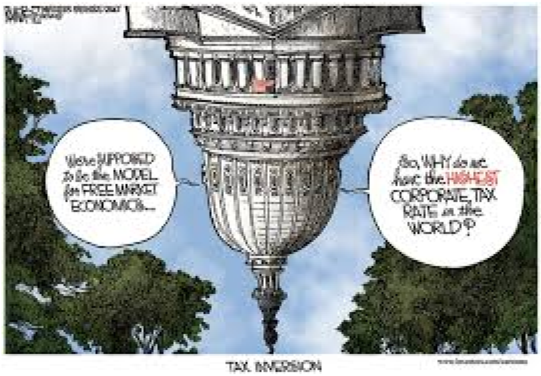
September 24, 2014 - U.S. Treasury Tightening Corporate Inversion Rules - By Jeffrey Hagenmeier

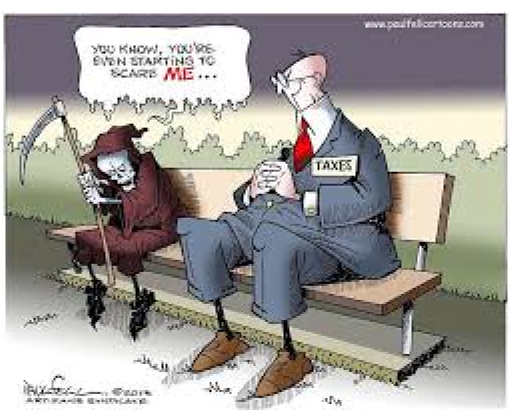


The United States Treasury Secretary Jacob Lew has ordered a crackdown on **corporate inversions.** These business inversions are when American based corporations buy companies overseas in mergers and then move their corporate headquarters overseas. This is done to avoid paying the corporate tax rate imposed by the United States Treasury. It is being done by an ever greater number of American businesses to avoid the highest corporate tax rate in the developed world. The rate of 35% is much higher than than what companies will pay in Europe, Asia or even Latin America. It allows companies to shield more of their profits from government taxation. About 50 American companies have done inversions in the last ten years, but more are considering it.

The announcement came late Monday afternoon on September 22nd. It should of came as no surprise. The American President Obama had railed against the practice for the last few months. The issue came to a head when the drug retail chain Walgreens was deciding on whether to leave the United States for this reason. Soon after the American burger chain Burger King also was contemplating on moving the corporate headquarters to Canada, after the proposed purchase of Tim Hortons.

The tax changes imposed by the Treasury, will make it harder for companies to complete overseas mergers. If American companies choose to invest in the purchase of overseas businesses anyways, they will find it more difficult using the revenue generated from these sources. Any cash accumulated abroad will be even more difficult to repatriate than it already is.

Most American corporations have used creative techniques to lower their tax bill. The utilization of the inversion was one of them. The United States government is also going to make it harder for American companies to make themselves *foreign* in the first place. This will be achieved by tightening ownership requirements.



The new rules are effective immediately. They will apply to all corporate deals, that had not been consummated by the end of the business day Monday.

President Obama publicly stated that he did not care if tax inversions were legal, in his mind they were wrong. According to the Treasury Secretary using corporate inversion at this point, would *no longer make economic sense* for any companies considering such a move for tax purposes. The President presents the issue that in his opinion, American companies need to pay their *fair share*, whatever that means. It has become an economic patriotism issue for the Obama Administration.

Of course real tax reform will need congressional action, which is unlikely until the inauguration of a new Congress in January of 2015.

Burger King has repeatedly denied that their $11.5 billion USD (United States Dollar) purchase of Tim Hortons and possible corporate move to Canada, has anything to do with trying to save on taxes. They took special pains, to put out that both companies paid similar tax rates last year.

Burger King or any other company for that matter, should not have to explain the reason for purchases and corporate re-locations of company assets. The management of Burger King should be concentrating on maximizing profits for their share holders. If they decide to be better corporate citizens because it makes good business sense, so be it. However, this should not be a requirement of a company doing business in the United States.

Walgreens decided to not move corporate headquarters to Switzerland, after the political outcry that was generated in the nation's capital. It was not worth the negative publicity, as was presumably determined by the management of the company. However, the company stock did suffer as a result of the decision.

Of course in reality, there really is no way even with the new law, to prevent corporate inversions. Neither can they prevent a company once it has moved, from paying the rate of taxation that is applied by the host country.

The announcement did have somewhat of an effect though. Companies like the pharmaceutical giant AbbVie and medical device behemoth Medtronic are both trying to buy companies in Ireland for inversion purposes. Shares in both of these companies and the two in Ireland suffered in value, with the announcement by U.S. Treasury Secretary Jacob Lew.

Medtronic will most likely go forward with the $43 billion USD takeover of Irish based Covidien Plc. The new Treasury rules will just complicate the process. AbbVie has not stated yet whether it will proceed with the $55 billion USD deal with Irish drug-maker Shire. It might however, deter the American pharmaceutical company Pfizer, from making another attempt in acquiring AstraZeneca after the $118 billion USD deal failed last May.

The American government targeted some methods as part of the corporate inversion process. One is the employment of *hopscotch* loans. This is where companies shift earnings by lending money to the new foreign parent company, while jumping over the U.S. based company.

The second is the stock ownership rule. It states that American company shareholders must own less than 80% of the new combined company, in order for it to be considered a foreign corporation. The Obama Administration would like to drop that to 50%, but that will take Congressional action.

The best and easiest solution to the issue of corporate inversion, is to simply lower the corporate tax rate. That would make it less likely that American companies would want to move overseas. It is a political issue at the movement. It is not good for business overall, neither at the domestic or international level. Increased government involvement rarely is.