BerkeleyLaw
UNIVERSITY OF CALIFORNIA
Berkeley Center for Law,
Business and the Economy

University of California, Berkeley
School of Law
2850 Telegraph Ave, Suite 500
Berkeley, CA 94705-7220

Ph: 510.642.0532 – Fax: 510.643.7095
E-mail: BCLBE@law.berkeley.edu
http://www.law.berkeley.edu/bclbe.htm

Treasury Releases New Guidance on Inversions
By Vinh-Khoi Le, J.D. Candidate 2016 | November 23, 2015

On Thursday, November 19, 2015, the Treasury Department issued a second notice designed to limit the tax benefits of overseas tax-inversion deals. This notice is a continuation of the US government's recent anti-inversion actions, including the notice that the Treasury Department issued on September 22, 2014.

"Last year, Treasury took targeted action to address inversions," said Treasury Secretary Jacob J. Lew. "This notice made a real difference by reducing some of the economic benefits of inversions, resulting in a decline in the pace of these transactions. This next action makes it even harder to invert, and further reduces the tax benefits for U.S. companies. While we intend to take additional action in the coming months, there is only so much the Treasury Department can do to prevent these tax-avoidance transactions. Only legislation can decisively stop inversions. The Administration has been working with Congress in an effort to reform our business tax system and address the issue of corporate inversions."

Tax inversions occur when a foreign company engages in a stock or asset merger with, or acquisition of, a domestic company that moves the company's domicile outside of the US. This would potentially reduce the ability of the IRS to tax the domestic company's worldwide income, as the domestic company as a whole is no longer in the United States. The domestic company would still be subject to US taxation on the income that it generates within the US.

IRC § 7874 sought to curb tax inversions by punishing "whale-minnow" mergers and acquisitions designed for the primary purpose of inversion. Under § 7874(b), if former shareholders of the expatriated entity own greater than 80% (by vote or value) of the foreign acquiring corporation, then there is no gain to the expatriated entity. However, the foreign acquiring corporation is treated as a domestic corporation. Under § 7874(a), if the former shareholders of the expatriated entity own 60-80% (by vote or value) of the foreign acquiring corporation then the expatriated entity recognizes inversion gain. Any deferred portion of the inversion gain continues to be recognized for 10 years.

The current notice makes it harder to engage in a tax inversion by 1) limiting domestic companies' ability to combine with foreign entities using a "third country" parent, 2) limiting domestic companies' ability to inflate the new foreign parent so as to avoid the 80% ownership rule, and 3) requiring the foreign parent to be a tax resident of its country of incorporation. The Treasury said these actions apply to deals on or after November 19, 2015.

The notice came after Ireland-based Allergan confirmed last month that it was working with Pfizer on a potential merger, which could have tax inversion implications. The companies say that they are in the final rounds of a stock-for-stock deal, but are waiting to proceed until they receive guidance from the Treasury Department.