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Johnson Controls among the First Tax Inverters of 2016

By Claire Oxford, J.D. Candidate 2018 | February 12, 2016

In one of the first big mergers of the year, Milwaukee-based Johnson Controls will combine with Tyco and move their corporate domicile abroad to Cork, Ireland. The move will save Johnson Controls an estimated $150 million in taxes per year.

Johnson Controls is not the first American company to seek a tax haven abroad. This move is known as "tax inversion," which is when a company moves its corporate headquarters to a low-income-tax country while continuing its material operations in its original country. Since 1982, an estimated 51 U.S. companies have reincorporated in low-tax countries abroad.

Legislators intended to end the practice of tax inversion with a new law in 2004, but were unsuccessful. The IRS tightened regulations on overseas reincorporation in September 2014, and again this past November, but so far have failed to bring an end to the practice.

Tax inversion remains appealing to corporations because the U.S. has the highest corporate income tax in the developed world at thirty-five percent. Additionally, the U.S. is one of the few countries that taxes all global income, in contrast to nations such as the U.K. or Canada which collect taxes only from domestic profits. Furthermore, the U.S. allows companies with foreign parent companies to deduct payments to their own affiliates abroad. Thus, this creates a significant tax incentive for a U.S.-based company to merge with or reincorporate as a foreign entity.

Both the left and the right decry tax inversions, but struggle to find a consensus about how to prevent them. Republicans add tax inversions to their list of complaints about the current tax system, saying that the only solution would be a complete revamp of the tax code. Presidential hopeful Senator Hillary Rodham Clinton has said tax inverters "shirk U.S. tax obligations" and "leave American taxpayers holding the bag." She proposes a high exit tax for corporations trying to leave the country. Her competitor, Senator Bernie Sanders, called these companies "corporate deserters" and stated that anybody taking advantage of being an American company must also pay American taxes. With the party divisions, it is unlikely that a plan to address these issues would pass through a divided Congress.

Last year, Johnson Controls paid a tax rate of roughly nineteen percent while headquartered in Wisconsin, compared to Irish Tyco's fourteen percent rate. However, the tax benefits are not the only reason the merger is appealing. Both Johnson Controls and Tyco aim to increase profits by eliminating duplications in the business. Johnson Controls' chairman and chief executive, Alex Molinaroli, emphasized in interviews with the New York Times that the merger was motivated by "finding ways to grow in the building products market and take advantage of the technology innovation."

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Robert Olson, CFO for Tyco, explained that the merger was well within the IRS guidelines, and that this merger is less about tax synergies and more about operating potential. In order to reincorporate abroad, shareholders in the American company must own less than sixty percent of the joint entity. Johnson Controls will own fifty-six percent of the shares in the new company, while Tyco will own forty-four percent.

Regardless of the motivation, the tax benefits to Johnson Controls–and losses to the American tax system–are staggering. The bipartisan support for reducing or eliminating tax inversion certainly indicates it is a practice worth examining.