Traps in the U.S. Inversion Rules for the Unwary Nonresident

Robert Ladislaw, Esq.

rladislaw@solblum.com

Inversions
U.S. Government Perspective

SOLOMON
BLUM
HEYMANN LLP

Inversion Transaction: A U.S. parent of a multinational corporate group is replaced with a foreign parent, often in a low-tax jurisdiction such as Bermuda. In addition to removing foreign operations from U.S. taxing jurisdiction, the U.S. corporation may transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation. Joint Committee on Taxation, June 6, 2002.

Inversions
U.S. Government Perspective

SOLOMON
BLUM
HEYMANN LLP

Examples of well-publicized inversions in the late 1990's and early 2000's:

- Ingersoll-Rand (Bermuda/Ireland)
- Tyco (Bermuda/Ireland)
- Stanley Works proposed (abandoned due to threat of law change)

Congress ramps up rhetoric: "In an inversion, a U.S. corporation pretends to move its headquarters to a phony shell corporation that is nothing more than a folder in a filing cabinet or a post box in a tax haven." Senate Finance Committee Chairman Charles Grassley, May 23, 2003.

Congressional Response: New IRC Sec. 7874, effective March 4, 2003 (retroactive, law passed in 2004)

IRC Sec. 7874

SOLOMON BLUM HEYMANN LLP

- Foreign corporation directly or indirectly acquires substantially all of the assets of a U.S. domestic corporation or domestic partnership.

- Stock of foreign corporation is held by former shareholders of the domestic corporation or former partners of the domestic partnership:
  - 60% Test: Inversion gain.
  - 80% Test: Foreign corporation is treated as domestic corporation for **all** U.S. tax purposes.

- Exception: "Expanded affiliated group" has substantial business activities in foreign country of incorporation.

Inversions Continue

SOLOMON
BLUM
HEYMANN LLP

Large U.S.-parented multinationals continued to invert, prompting mounting outrage from the media and U.S. politicians.

Noted Inversions:

- Medtronic (Ireland) (largest) (takeover of Covidien)
- Delphi (Jersey/U.K.) (bankruptcy reorganization)
- Mylan (Netherlands) (merged with Abbott)
- Valeant Pharmaceuticals (Canada) (merged with Biovail)
- Lazard (Bermuda) (IPO)

Inversions - Zenith of Outrage

SOLOMON
BLUM
HEYMANN LLP

•Burger King merged with Tim Hortons of Canada in December 2014 in a successful inversion. President Obama said inverting companies are "corporate deserters who renounce their citizenship to shield profits."

•U.S. pharmaceutical Pfizer agreed to acquire Allergan PLC (Ireland) for $160 billion in late 2015 in an attempted inversion, which would have reduced its effective tax rate from 23.4% to 17% - 18%, possibly resulting in tax savings of $1B annually. Candidate Trump called the proposed deal "disgusting." Candidate Clinton said the proposed deal "will leave U.S. taxpayers holding the bag."

2016 Regulations

SOLOMON
BLUM
HEYMANN LLP

2016 Regulations

SOLOMON
BLUM
HEYMANN LLP

Pfizer and Allergan Merger Targeted

Treas. Reg. Sec. 1.7874-8T: Aimed at "serial inverters". 3 years of past mergers with U.S. corporations disregarded for purposes of the stock ownership tests.

Allergan's previous history as an acquirer of other U.S. companies would have reduced or eliminated the tax benefits from the merger. The deal was scrapped.

Impact on Nonresidents

SOLOMON
BLUM
HEYMANN LLP

The inversion rules appear to be aimed at large U.S. parented multinationals.

Can the inversion rules impact nonresidents with investments in the United States who are engaged in estate planning or tax planning?

Yes!

Impact on Nonresidents

SOLOMON BLUM HEYMANN LLP

IRC Sec. 7874(b): Inverted corporations are treated as U.S. domestic corporations "for purposes of *this title*." The inversion rules apply for U.S. estate and gift tax purposes.

- **Domestic corporations are U.S. situs property for estate tax purposes.**

IRC Sec. 7874(f): The inversion rules override *all* tax treaty provisions to the contrary.

Treas. Reg. § 1.7874-2(c)(1): Indirect acquisition - An acquisition of stock of a domestic corporation or an interest in a partnership by a foreign corporation.

All transactions must be tested, no matter the value.

Traps for Nonresidents

SOLOMON
BLUM
HEYMANN LLP

Potential tax problems for nonresident investors from inversion rules

Estate tax problem: If a nonresident owns a foreign company treated as a U.S. domestic corporation under the inversion rules, it will be U.S. situs property on the death of the nonresident for U.S. estate tax purposes.

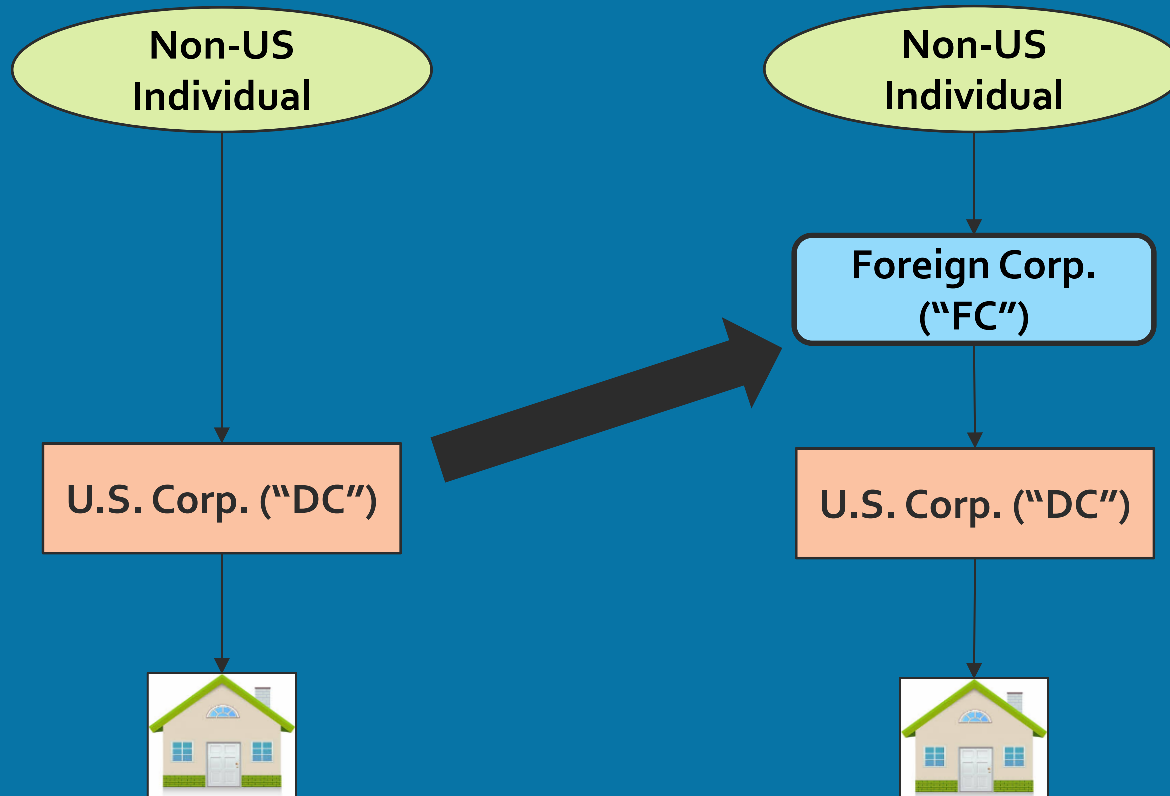
Foreign corporation that is treated as U.S. domestic under the inversion rules will create income tax headaches:

- Corporation resident in two countries
- Subjects the corporation to U.S. taxation and reporting on worldwide income and assets.

Estate Planning Trap
Investment in Real Property

SOLOMON
BLUM
HEYMANN LLP

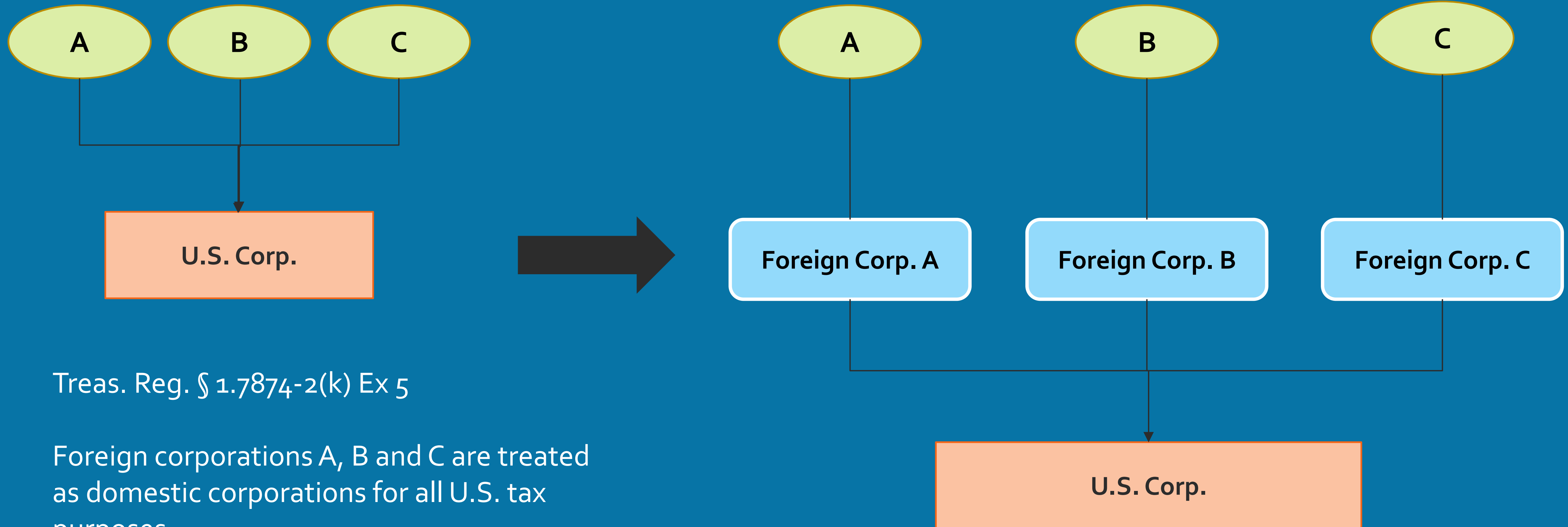
ESTATE TAX PLANNING



An acquisition by FC of stock of DC is considered an indirect acquisition of the assets of DC. As a result, FC is classified as a U.S. domestic corporation for estate tax purposes.

Acquisitions by Multiple Foreign Corporations

SOLOMON
BLUM
HEYMANN LLP



Treas. Reg. § 1.7874-2(k) Ex 5

Foreign corporations A, B and C are treated as domestic corporations for all U.S. tax purposes.

Exception
Substantial Business Activities

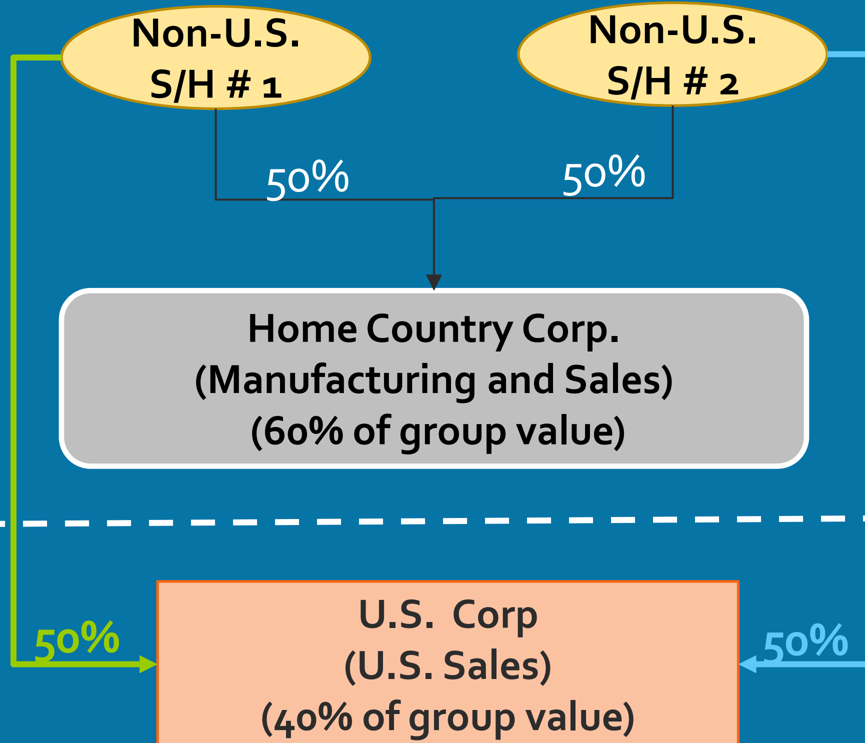
SOLOMON
BLUM
HEYMANN LLP

- Expanded affiliated group has substantial business activities in country of organization.
- Expanded affiliated group means corporations and partnerships owned more than **50%**, connected with a common parent corporation.
- Substantial business activities:
  - EAG employees in relevant foreign country at least 25% of total employees and earn at least 25% of total compensation.
  - EAG tangible business assets in relevant foreign country is at least 25% of total assets.
  - EAG business income in relevant foreign country is equal to at least 25% of total income.

Brother-Sister Group Trap

SOLOMON BLUM HEYMANN LLP

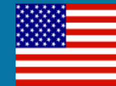
Before

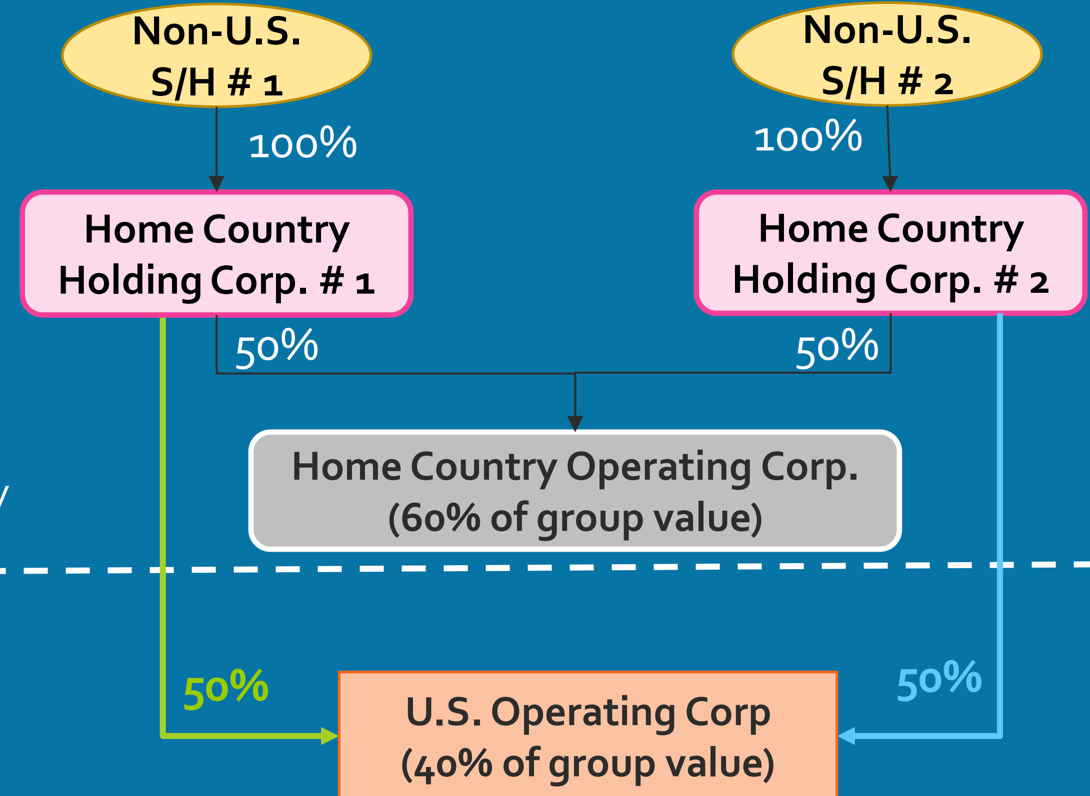


Home Country

After (proposed)

Home Country





Brother-Sister Group Trap
Questions

SOLOMON
BLUM
HEYMANN LLP

- Are holding corporations domestic for all U.S. tax purposes?
- Is this example 5?
- Substantial business activities exception? Problem: The two holding corporations are not part of the same EAG.
- Can the structure be fixed?:
  - A single holding company would create an EAG with significant business activities in the home country.
  - Entity classification election for each holding corporation? U.S. estate tax?

Future of Inversion Rules

SOLOMON
BLUM
HEYMANN LLP

Trump Proposal: Cut corporate tax rate from 35% to 15%, which will reduce the incentive to invert.

If the corporate rate is reduced will the inversion rules stay in place?

Thank You

SOLOMON
BLUM
HEYMANN LLP

For further information please contact us:

Robert Ladislaw: rladislaw@solblum.com

NEW YORK

40 Wall Street , 35th Floor
New York, NY 10005

212.267.7600
212.267.2030 (fax)

VIRGIN ISLANDS

Royal Palms Professional Building
Suite 101

9053 Estate Thomas
St. Thomas, VI 00802`