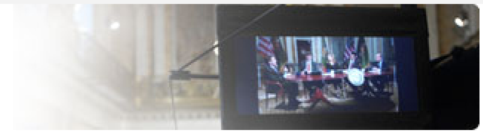
U.S. DEPARTMENT OF THE TREASURY

Press Center



Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions

9/22/2014

Actions under sections 304(b)(5)(B), 367, 956(e), 7701(l), and 7874 of the Code

What is a corporate inversion?

A corporate inversion is transaction in which a U.S. based multinational restructures so that the U.S. parent is replaced by a foreign parent, in order to avoid U.S. taxes. Current law subjects inversions that appear to be based primarily on tax considerations to certain potentially adverse tax consequences, but it has become clear by the growing pace of these transactions that for many corporations, these consequences are acceptable in light of the potential benefits.

An inverted company is subject to potential adverse tax consequences if, after the transaction: (1) less than 25 percent of the new multinational entity's business activity is in the home country of the new foreign parent, and (2) the shareholders of the old U.S. parent end up owning at least 60 percent of the shares of the new foreign parent. If these criteria are met for an inverted company, the tax consequences depend on the continuing ownership stake of the shareholders from the former U.S. parent. If the continuing ownership stake is 80 percent or more, the new foreign parent is treated as a U.S. corporation (despite the new corporate address), thereby nullifying the inversion for tax purposes. If the continuing ownership stake is at least 60 but less than 80 percent, U.S. tax law respects the foreign status of the new foreign parent but other potentially adverse tax consequences may follow. The current wave of inversions involves transactions in this continuing ownership range of 60 to 80 percent.

Genuine cross-border mergers make the U.S. economy stronger by enabling U.S. companies to invest overseas and encouraging foreign investment to flow into the United States. But these transactions should be driven by genuine business strategies and economic efficiencies, not a desire to shift the tax residence of the parent entity to a low-tax jurisdiction simply to avoid U.S. taxes.

Today, Treasury is taking action to reduce the tax benefits of — and when possible, stop — corporate tax inversions. This action will significantly diminish the ability of inverted companies to escape U.S. taxation. For some companies considering mergers, today's action will mean that inversions no longer make economic sense.

Specifically, the Notice eliminates certain techniques inverted companies currently use to access the overseas earnings of foreign subsidiaries of the U.S. company that inverts without paying U.S. tax. Today's actions apply to deals closed today or after today.

This notice is an important initial step in addressing inversions. Treasury will continue to examine ways to reduce the tax benefits of inversions, including through additional regulatory guidance as well as by reviewing our tax treaties and other international commitments. Today's Notice requests comments on additional ways that Treasury can make inversion deals less economically appealing.

Specifically, today's Notice will:

- **Prevent inverted companies from accessing a foreign subsidiary's earnings while deferring U.S. tax through the use of creative loans, which are known as "hopscotch" loans**(*Action under section 956(e) of the code)*
  - Under current law, U.S. multinationals owe U.S. tax on the profits of their controlled foreign corporations (CFCs) although they don't usually have to pay this tax until those profits are repatriated (that is, paid to the U.S. parent firm as a dividend). Profits that have not yet been repatriated are known as deferred earnings.
  - Under current law, if a CFC, tries to avoid this dividend tax by investing in certain U.S. property—such as by making a loan to, or investing in stock of its U.S. parent or one of its domestic affiliates—the U.S. parent is treated as if it received a taxable dividend from the CFC.
  - However, some inverted companies get around this rule by having the CFC make the loan to the new foreign parent, instead of its U.S. parent. This "hopscotch" loan is not currently considered U.S. property and is therefore not taxed as a dividend.
  - Today's notice removes benefits of these "hopscotch" loans by providing that such loans are considered "U.S. property" for purposes of applying the anti-avoidance rule. The same dividend rules will now apply as if the CFC had made a loan to the U.S. parent prior to the inversion.
- **Prevent inverted companies from restructuring a foreign subsidiary in order to access the subsidiary's earnings tax-free***(Action under section 7701(l) of the tax code)*
  - After an inversion, some U.S. multinationals avoid ever paying U.S. tax on the deferred earnings of their CFC by having the new foreign parent buy enough stock to take control of the CFC away from the former U.S. parent. This "de-controlling" strategy is used to allow the new foreign parent to access the deferred earnings of the CFC without ever paying U.S. tax on them.
  - Under today's notice, the new foreign parent would be treated as owning stock in the former U.S. parent, rather than the CFC, to remove the benefits of the "de-controlling" strategy. The CFC would remain a CFC and would continue to be subject to U.S. tax on its profits and deferred earnings.
- **Close a loophole to prevent an inverted companies from transferring cash or property from a CFC to the new parent to completely avoid U.S. tax** (*Action under section 304(b)(5)(B) of the code)*
  - These transactions involve the new foreign parent selling its stock in the former U.S. parent to a CFC with deferred earnings in exchange for cash or property of the CFC, effectively resulting in a tax-free repatriation of cash or property bypassing the U.S. parent. Today's action would eliminate the ability to use this strategy.

- **Make it more difficult for U.S. entities to invert by strengthening the requirement that the former owners of the U.S. entity own less than 80 percent of the new combined entity:**
  - <u>Limit the ability of companies to count passive assets that are not part of the entity's daily business functions in order to inflate the new foreign parent's size and therefore evade the 80 percent rule – known as using a "cash box.</u> (*Action under section 7874 of the code)* Companies can successfully invert when the U.S. entity has, for example, a value of 79 percent, and the foreign "acquirer" has a value of 21 percent of the combined entity. However in some inversion transactions, the foreign acquirer's size is inflated by passive assets, also known as "cash boxes," such as cash or marketable securities. These assets are not used by the entity for daily business functions. Today's notice would disregard stock of the foreign parent that is attributable to passive assets in the context of this 80 percent requirement. This would apply if at least 50 percent of the foreign corporation's assets are passive. Banks and other financial services companies would be exempted.

  - <u>Prevent U.S. companies from reducing their size pre-inversion by making extraordinary dividends.</u> (*Action under section 7874 of the code)* In some instances, a U.S. entity may pay out large dividends pre-inversion to reduce its size and meet the 80 percent threshold, also known as "skinny-down" dividends. Today's notice would disregard these pre-inversion extraordinary dividends for purposes of the ownership requirement, thereby raising the U.S. entity's ownership, possibly above the 80 percent threshold.

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  - <u>Prevent a U.S. entity from inverting a portion of its operations by transferring assets to a newly formed foreign corporation that it spins off to its shareholders, thereby avoiding the associated U.S. tax liabilities, a practice known as "spinversion."</u> (*Action under section 7874 of the code)* In some cases a U.S. entity may invert a portion of its operations by transferring a portion of its assets to a newly formed foreign corporation and then spinning-off that corporation to its public shareholders. This transaction takes advantage of a rule that was intended to permit purely internal restructurings by multinationals. Under today's action, the spun-off foreign corporation would not benefit from these internal restructuring rules with the result that the spun off company would be treated as a domestic corporation, eliminating the use of this technique for these transactions.