The Harvard Law School Forum on Corporate Governance and Financial Regulation
SUPPORTED BY: CSC CORPORATION SERVICE COMPANY

An Upturn in "Inversion" Transactions

Posted by Adam O. Emmerich, Wachtell Lipton Rosen & Katz, on Wednesday April 30, 2014

Editor's Note: Adam Emmerich is a partner in the corporate department at Wachtell, Lipton, Rosen & Katz focusing primarily on mergers and acquisitions and securities law matters. This post is based on a Wachtell Lipton firm memorandum by Mr. Emmerich, Jodi J. Schwartz, and Igor Kirman.

Recently, there have been a growing number of large "inversion" transactions involving the migration of a U.S. corporation to a foreign jurisdiction through an M&A transaction. Inversion transactions come in several varieties, with the most common involving a U.S. company merging with a foreign target and redomiciling the combined company to the jurisdiction of the target.

While inversion transactions tend to have strong strategic rationales independent of tax considerations, the tax benefits can be significant. These benefits are varied but start with relatively high U.S. corporate tax rates and U.S. taxation of foreign earnings when repatriated to the U.S. Among other things, an inverted company may achieve a lower effective tax rate on future earnings, be able to access its non-U.S. cash reserves in a tax-efficient way, and have a more favorable profile for future acquisition activity.

Corporations that might once have pursued single-entity reincorporation strategies to save on taxes have found that option more difficult as a result of the continually evolving U.S. anti-inversion rules. Instead, the recent trend has been to reincorporate in connection with a business combination, which requires, among other things, that the foreign party's shareholders own at least 20% of the shares of the combined company. While an inversion may involve shareholder level tax for the buyer, many shareholders are tax-insensitive and the market has tended to reward buyers pursuing inversions even in taxable transactions. Companies have now begun to experience pressure from shareholders to pursue inversion transactions.

There are a number of jurisdictions with favorable tax regimes and treaty networks and robust corporate laws that are attractive jurisdictions for a holding company, including Ireland (popular with many recent pharmaceutical inversions), the U.K., the Netherlands and Switzerland. While parties often choose to reincorporate to the jurisdiction of the foreign merger partner, sometimes

a different country is chosen, particularly where there may be tax, social or political benefits to choosing a third country. In addition, it is critical to consider the broader legal and corporate governance framework in which the combined company would operate, including factors such as residency and meeting requirements, reporting obligations, directors' duties and liabilities, the executive compensation regime and exposure to activism and hostile takeovers. Inversions therefore require a thorough understanding of the consequences of choosing one jurisdiction over another, in addition to presenting the typical complexities that arise in cross-border deals. Nonetheless, in light of the significant value that can be created—and the pressure to act before possible future regulatory action lessens the benefit of such deals—the inversion trend can be expected to continue in the near future.