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Merging U.S. Firms Select European Headquarters to Reduce Taxes

by Stuart Webber

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Since the late 1990s several U.S. firms have relocated their corporate headquarters abroad to reduce income taxes and exit a complex U.S. system that taxes worldwide income. In response, the U.S. Congress and Treasury Department have enacted rules that make it more difficult and costly for firms to transfer their headquarters abroad. While it appears those rules have been effective at preventing an exodus of U.S. firms, in general those regulations have not applied when U.S. companies have merged with foreign enterprises. Since 2012 at least eight U.S.-based firms have merged with overseas businesses, selected the European site as the combined enterprise's headquarters, and significantly reduced their income tax expense. In some cases the merging firm's U.S. operations are significantly larger than the merger partner's, and the firm will be managed and controlled from the United States. But for tax purposes each firm will be headquartered in Europe, significantly reducing income tax obligations.

Over the past 15 years U.S. multinational corporations (MNCs) have used various techniques to relocate their headquarters, based upon the tax laws then in effect. In the late 1990s there were few laws that restricted such relocations, and some U.S. firms moved their headquarters to Caribbean tax havens. When transferring their headquarters those firms did not make any substantive change in the firm's management or operations; they continued to be managed by senior officers located in the United States. Those relocations were controversial in the United States, and in 2004 Congress enacted legislation making it more difficult and costly for firms to relocate their headquarters abroad.[1] In 2008 and 2009 some of these Caribbean-headquartered firms relocated a second time to Europe, citing concerns the United States would find ways to apply U.S. international tax laws to those businesses, or withhold government contracts from firms headquartered in these tax havens.[2] Between 2010 and 2012 three firms moved their corporate headquarters from the United States to the United Kingdom, but in these cases the firms said they had a substantial business presence in that country and that the business would be managed there. In response the Treasury Department released more stringent tax regulations in June 2012 that made it more difficult for American firms to relocate abroad.[3] However, the new regulations have not changed existing rules, which allow headquarter relocations as part of a business merger, in certain situations.

The purpose of this article is to provide an overview of the history of U.S. corporate headquarters relocations, specifically focusing on recent developments. These recent developments include changes to U.S. tax regulations governing corporate relocations, and the

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[1]Stuart Webber, ''Escaping the U.S. Tax System: From Corporate Inversions to Re-Domiciling,'' *Tax Notes Int'l*, July 25, 2011, p. 273.

[2]Webber, ''Inverted U.S. Firms Relocate Headquarters to Europe,'' *Tax Notes Int'l*, Nov. 21, 2011, p. 589.

[3]*See Fed. Reg.*, Vol. 77, No. 113 (June 12, 2012).

Table 1. U.S. Corporate Inversions/HQ Relocations (1997-2010)

Firm	Original Inversion	Home	Subsequent Relocation	New Home
Transocean	1999	Cayman Islands	2008	Switzerland
Cooper Industries	2001	Bermuda	2009	Ireland
Ingersoll-Rand	2001	Bermuda	2009	Ireland
Noble Corp.	2002	Cayman Islands	2009/2013	Switzerland/U.K.
TE Connectivity (formerly Tyco Electronics)	1997	Bermuda	2009	Switzerland
Tyco International	1997	Bermuda	2008	Switzerland
Covidien	1997	Bermuda	2010	Ireland
Nabors Industries	2002	Bermuda	N/A	

mergers that have taken place since 2012. In particular, I will focus on some recent international mergers in which U.S. firms have selected new European headquarters.

Corporate Inversions

In the late 1990s and early 2000s, some U.S.-headquartered firms moved their corporate headquarters to Caribbean tax havens to reduce income taxes and avoid the U.S. tax system's complexities. These actions were called corporate inversions because the enterprises formed new parent companies located in a tax haven, and the former parent company dropped down to become a subsidiary of the new corporate parent. Between 1997 and 2002 six members of the S&P 500 Index relocated to tax havens.[4] In response, Congress enacted IRC section 7874 in 2004, which made it more difficult and costly for firms to invert. This code section will be discussed in more detail later in this article.

The destination for these corporations was either the Cayman Islands or Bermuda. Tyco transferred its headquarters from the United States to Bermuda in 1997, and Transocean moved its corporate headquarters to the Cayman Islands in 1999. In 2001 Cooper Industries and Ingersoll-Rand relocated their headquarters to Bermuda. In 2002 Nabors Industries left for Bermuda, and Noble Corp. transferred its headquarters to the Cayman Islands.[5] In all cases these transactions occurred by filing new incorporation papers in these sites, and designating that location as the headquarters site of the worldwide enterprise. This new corporate headquarters then acquired the stock or the assets of the former parent. However, the management and control of these enterprises remained in the United States, as did the firms' senior officers. These were purely legal transactions that had no material impact upon the management or operations of these businesses.

After Tyco's original corporate inversion, that firm split into three businesses: TE Connectivity (formerly Tyco Electronics), Tyco International, and Covidien. All of these businesses were headquartered in Bermuda, and each was included in the S&P 500 Index. As a result, there were eight members of the S&P 500 Index located in Caribbean tax havens and formerly headquartered in the United States.[6] Of these eight firms, seven relocated their headquarters a second time, moving their corporate tax home to either Switzerland or Ireland.[7] Transocean moved its headquarters from the Cayman Islands to Switzerland in 2008. Cooper Industries and Ingersoll-Rand moved from Bermuda to Ireland in 2009. Noble Corp. moved from the Cayman Islands to Switzerland in 2009 and relocated again to the United Kingdom in 2013. Tyco International relocated its headquarters from Bermuda to Switzerland in 2008, and TE Connectivity did the same in 2009. Covidien transferred its headquarters from Bermuda to Ireland in 2010. Of the original eight firms listed, only Nabors Industries did not relocate again. Table 1 is a summary of those actions.

Each of the relocating enterprises offered similar reasons for moving its headquarters a second time. In SEC filings the firms cited concerns that Congress would enact legislation that might tax them as U.S.-headquartered businesses. Further, they were concerned Congress would deny government contracts to

[4]Mihir Desai and James R. Hines Jr., ''Expectations and Expatriations: Tracing the Causes and Consequence of Corporate Inversions,'' *Nat'l Tax J.*, LV(3) (2002), p. 416.

[5]*Id.*

[6]Webber, *supra* note 2.

[7]*Id.*

firms headquartered in known tax havens. These businesses decided to exit Bermuda and the Cayman Islands for less controversial corporate homes before Congress could enact such legislation. Several of the firms said that before selecting a European home they considered relocating back to the United States but were dissuaded by high U.S. income tax rates. Several firms also said the cost of complying with the complex worldwide U.S. tax system was a factor in their decision. All of the firms said the extensive networks of tax treaties in both Ireland and Switzerland were motivations to relocate there. Those that selected Ireland often had business operations there and were drawn by its low tax rates, common law legal system, and English-speaking populace. Those selecting Switzerland also frequently had business operations there and were attracted to its long history as a corporate home for MNCs, with a well-developed corporate legal system.[8]

Determining an MNC's Tax Home

The United States' approach to determine an MNC's tax headquarters differs from that of most European countries. In general, the United States determines the worldwide headquarters of an MNC based on where incorporation papers for the parent firm are filed. These are known as place of incorporation rules. Most European countries determine a firm's headquarters by identifying the location where the worldwide enterprise is managed. These are commonly called real seat rules.

Kane and Rock (2008) explain the difference this way. They write:

> a legal system can adopt either the ''place of incorporation'' (''POI'') rule or some version of the ''real seat'' (''RS'') rule. Under the POI rule, the corporation's location is determined by where it was incorporated, a purely formal criterion. Under the RS rule, a corporation's location depends on some combination of factual elements, such as the location of the administrative headquarters or the location of the firm's center of gravity as determined by the location of the employees and assets. The place of incorporation can also bear on this question, but it is not determinative.[9]

Kane and Rock also note that in general the United States and Canada use place of incorporation rules for tax purposes.[10] In contrast, Kane and Rock state: ''With respect to corporate tax, on the whole, E.U. member states apply an RS locational rule.''[11]

The distinction between place of incorporation and real seat rules can occasionally become less distinct, so this is not a hard and fast distinction. For example, while the United States generally determines a firm's headquarters through place of incorporation rules, when firms relocate abroad, the United States will also consider whether the firm has a substantial business presence in the new location. If the business has a substantial business presence in the new site, the United States may respect the move and recognize it as a foreign enterprise. If not, it may continue to tax that business as a U.S.-headquartered business. Thus, while it is generally correct to say the United States generally enforces place of incorporation rules, in some situations a firm's business presence in the new corporate home may be relevant. Nonetheless, the distinction Kane and Rock make between place of incorporation rules and real seat rules is generally accurate and useful.

Firms are often able to take advantage of such rule differences. For example, in the summer of 2013 Apple CEO Tim Cook testified that one of its subsidiaries did not have a tax home. According to U.S. place of incorporation rules, the subsidiary was headquartered in Ireland. But according to Ireland's real seat rules it was not headquartered there. Thus, that Apple subsidiary was not domiciled in either country. Ireland's finance minister, Michael Noonan, several months later, said that it would take action to ensure that such firms do not remain stateless, and have a tax residency.[12]

IRC Section 7874

As mentioned, corporate inversions generated considerable controversy in the United States because of concerns that the federal government would lose tax revenue should more firms relocate abroad. Moreover, many individuals viewed inverting firms as unpatriotic. In response, Congress enacted IRC section 7874 in 2004, which made it more difficult and costly for firms to relocate their corporate headquarters overseas. The Senate Finance Committee's report explained the law this way: ''The Committee believes that inversion transactions resulting in a minimal presence in a foreign country of incorporation are a means of avoiding U.S. tax and should be curtailed.''[13] The key term in this statement appears to be minimal presence. The law Congress enacted was specifically crafted to prevent the inversions then taking place, in which U.S.-headquartered firms were relocating their headquarters though paper transactions to Bermuda or the Cayman Islands. The departing firms had little or no business operations in these locations, which Congress regarded as a key problem with those actions.

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[8]For more discussion of this topic, see Webber, *supra* note 2.

[9]Mitchell A. Kane and Edward B. Rock, ''Corporate Taxation and International Charter Competition,'' *Mich. L. Rev.*, Vol. 106, No. 7 (May 2008), p. 1235.

[10]*Id.* at 1266-1270.

[11]*Id.* at 1271.

[12]*See* Jamie Smyth and Richard Waters, ''Dublin to Shut Door on Apple Tax Loophole,'' *Financial Times* (Oct. 16, 2013), p. 1.

[13]S. Rep. No. 108-192, 108th Cong., 1st Sess., at 142 (Nov. 7, 2003).

Section 7874's goal was not to prevent U.S. firms from relocating their headquarters abroad in all circumstances. However, under specific conditions, the United States would not respect the move for tax purposes and would continue to tax the enterprise as a U.S.-headquartered firm. Under other conditions, the United States would respect the relocation for tax purposes, but it could increase the exit tax triggered by the inversion. It did this by denying tax deductions that can reduce the taxable gain due as a consequence of the headquarters relocation.

The law has three tests, all of which must be met for section 7874 to apply. The first test covers inversion transactions, in which a new corporate parent is formed and it acquires the stock, the assets, or both, of the former parent. The test is met when ''the entity completes after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership.''[14] This section covered the various legal techniques used to complete a corporate inversion. In some cases corporate inversions were structured as stock purchases, in other situations as asset purchases, and some were a combination of the two. Section 7874 covered all of these transactions.

The second test compares the firm's ownership before and after the relocation. If 80 percent or more of a firm's shares are owned by the same shareholders before and after the inversion, one set of rules applies. If 60 to 80 percent of the firm's shares are owned by the same shareholders, a second set is enforced. If the 80 percent plus test is met, the firm's tax status does not change and it is taxed as a U.S.-headquartered firm, assuming the other two conditions are met. Section 7874(a)(3) says in this case the inverted firm ''is treated as a domestic entity.'' In other words, the inversion will not be respected for tax purposes; U.S. tax policies and rates still apply. For other corporate law purposes the firm may be a foreign corporation, but for tax purposes it is still treated as a U.S.-headquartered enterprise.

If 60 to 80 percent of the firm's shares are owned by the same shareholders before and after the inversion, the firm's relocation abroad is respected but the exit tax associated with departing may increase.[15] An inversion gain is generally recognized when the U.S. entity sells its stock or assets to the new overseas parent. Section 7874 disallows some tax credits and losses that might reduce the inversion gain, and thus the taxes due for exiting. Leitner and Glicklich explained the impact this way:

> Under [section] 7874(a), the taxable income of an expatriated entity during the 10-year period beginning on the date of the acquisition ''shall in no event be less than'' the inversion gain of the expatriated entity. In addition, the inversion gain cannot be offset by any credits to which an expatriated entity might otherwise be entitled.[16]

In short, the taxable gain triggered by the inversion cannot be reduced by net operating losses or other tax credits. As a result, the firm's tax obligations caused by the corporate inversion may increase. However, the firm's relocation will be respected and it will no longer be taxed as a U.S.-headquartered firm.

On January 17, 2014, the Treasury Department issued new temporary regulations that may affect how the second test is calculated. These new regulations will be discussed later in this article.

Thus the percentage of shares that change hands at the time of the corporate inversion is a key factor to determine how section 7874 is applied. Jefferson VanderWolk said Congress wanted to prevent corporate inversions that were motivated primarily by tax objectives.[17] However, Congress did not want to prevent business combinations that were driven by more commercial purposes, as opposed to tax reduction goals. If there was little or no change in the ownership of a firm, this indicated the transaction was structured only to avoid the U.S. tax system. But if there was a substantial change in the ownership of a firm, this suggested the ''transactions would have sufficient non-tax effect to justify being respected for US tax purposes,''[18] according to VanderWolk.

The third test is whether the inverted firm has a substantial business presence in its new corporate home. If the firm does not have such a presence in that location, this test is met. The purpose is to prevent inversions to countries in which the multinational enterprise conducts minimal business, such as Caribbean tax havens. This test compares the volume of work performed in the new corporate home to that done by the entire worldwide enterprise, or what section 7874 calls ''the expanded affiliate group'' (EAG).[19] Section 7874 applies if ''after the acquisition the expanded affiliate group which includes the entity does not have substantial business activities in the foreign country in which, or under the laws of which, the entity is created or organized, when compared to the total business activities of the expanded affiliate group.''[20] If the firm does have a substantial business presence there, the inversion

[14]Section 7874(a)(2)(B)(i).

[15]Section 7874(a)(2)(B).

[16]Abraham Leitner and Peter A. Glicklich, ''New regulations tighten anti-inversion rules but probably won't stop U.S. corporate expatriation,'' *Tax Mgm't Int'l J.* (2009), pp. 515-516.

[17]Jefferson P. VanderWolk, ''Inversions Under Section 7874 of the Internal Revenue Code: Flawed Legislation, Flawed Guidance,'' *Nw. J. Int'l L. & Bus.* 30(3) (2010), pp. 4-7.

[18]*Id.* at 4.

[19]Section 7874(a)(2)(B)(iii).

[20]*Id.*

is respected and the firm can exit. However, section 7874 does not explain what constitutes a ''substantial business presence.'' The Treasury regulations provide more guidance on this topic.

Substantial Business Presence

As mentioned, IRC 7874's third test states that a firm is not subject to that law if it has a substantial business presence in its new headquarters location. However, the law does not explicitly define what constitutes a substantial business presence. This task was left to Treasury regulations. The Treasury Department released three different sets of Treasury regulations to define a substantial business presence. The first temporary section 7874 regulations were released in 2006, they were replaced in 2009, and a third set of temporary Treasury regulations was issued in June 2012.

The preamble to the 2012 temporary regulations explains the prior rules this way: ''The 2006 temporary regulations also provided a safe harbor, which generally was satisfied if at least ten percent of the employees, assets, and sales of the expanded affiliated group were in the relevant foreign country.''[21] The safe harbor gave a firm the assurance the IRS would not challenge a firm's position that it had a substantial business presence in its new headquarters location, assuming those tests were met. In 2006 tax authorities were concerned with firms departing for Caribbean tax havens, and in those situations there were few large U.S.-headquartered firms with 10 percent of their employees, assets, and revenue in locations such as Bermuda or the Cayman Islands. Thus, the regulations appear to have achieved congressional objectives at that time.

The 2006 temporary regulations were replaced with new rules that did not provide either a safe harbor or clear metrics to determine whether a firm had a substantial business presence in another country. Those regulations said several factors needed to be considered before a determination could be made whether a firm had a substantial business presence in another country. Those factors were:

- the historical conduct of continuous business activities in that country before the inversion;
- the presence of operational activities in that country, including property ownership, performance of services, and sales by EAG members;
- the presence of substantial managerial activities by EAG employees in that country;
- a substantial degree of ownership by investors residing in that country; and
- strategic factors including ''business activities in the foreign country that are material to the achievement of the EAG's overall business objectives.''[22]

However, the regulations did not explain the relative importance of each factor. The regulations stated: ''The presence or absence of any factor, or of a particular number of factors, is not determinative. Moreover, the weight given to any factor (whether or not set forth below) depends on a particular case.''[23] Thus, the facts and circumstances in each case need to be evaluated separately. Further, there was no safe harbor, so firms could not know in advance whether they had a substantial business presence in a country.

Some analysts thought the Treasury Department intentionally created subjective rules and removed the safe harbor to make it more difficult for taxpayers to know in advance if relocations would be respected. For example, Leitner and Glicklich wrote:

> Whether the IRS believes that the thresholds in the safe harbor and the facts of the examples were simply too generous — or whether the IRS prefers to retain a level of subjectivity and uncertainty to deter taxpayers from relying on the substantiality exception — is not entirely clear. However, a clue may exist where the Preamble notes that, in addition to the elimination of the safe harbor and examples, the question is whether the substantial business activities condition is satisfied will continue to be an area with respect to which the IRS will ordinarily not rule. The implication is that the IRS is intentionally making it more difficult for taxpayers to rely on the substantiality exception.[24]

Thus, Leitner and Glicklich suggest the IRS thought ambiguity would deter firms from relocating abroad.

Some were critical of this approach. For example, VanderWolk wrote:

> The inability to know the tax consequences of a major transaction is a real problem, which only the IRS and Treasury (or Congress) can solve. The sooner the IRS and Treasury can produce new guidance regarding the level of business activity in the foreign country or incorporation that will be considered ''substantial'' when compared to the total business activities of the group, the better for all concerned.[25]

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[21] *See Fed. Reg.*, Vol. 77, No. 113 (June 12, 2012).

[22] 2009 temp. reg. section 1.7874-2T(d)(1)(ii).

[23] *Id.*

[24] Leitner and Glicklich, *supra* note 16, at 521.

[25] VanderWolk, *supra* note 17, at 718-719.

VanderWolk argued that the 2009 regulations needed to be replaced with clear rules to define a substantial business presence so taxpayers could know in advance the tax impact of their actions.[26]

The IRS may have agreed with these criticisms, because the 2009 regulations were replaced in 2012 with temporary regulations that provided clearer guidance on this topic. Perhaps more importantly, the 2009 regulations did not prevent firms from relocating abroad. Between 2010 and 2012 three businesses relocated their headquarters from the United States to the United Kingdom, apparently undaunted by the 2009 regulations' subjectivity. In the preamble to the 2012 temporary regulations, the Treasury Department wrote:

> the IRS and the Treasury Department believe the facts and circumstances test of the 2009 temporary regulations should be replaced with a bright line rule describing the threshold of activities required for an expanded affiliated group to have substantial business activities in the relevant foreign country. The IRS and the Treasury Department believe that such a rule will provide more certainty in applying section 7874 to particular transactions than the 2009 temporary regulations and will improve the administrability of this provision.[27]

The 2012 regulations significantly increased the requirements to pass the substantial business presence test. The preamble to the 2012 regulations states: ''The 2012 temporary regulations provide that an expanded affiliated group will have substantial business activities in the relevant foreign country only if at least 25 percent of the group employees, group assets, and group income are located or derived in the relevant foreign country.''[28] All three measures must be met for a firm to have a substantial business presence abroad. As mentioned, the 2006 temporary regulations establish a 10 percent hurdle to achieve a substantial business presence, so the requirements to achieve a substantial business presence were significantly increased.

Temp. reg. section 1.784-3T(b)(1) explains the group employees test. It says that both 25 percent of a firm's employees and 25 percent of employee compensation must be in the new headquarters location. Temp. reg. section 1.7874-3T(b)(2) defines the assets requirement. It says that to pass this test ''the value of the group assets located in the relevant foreign country is at least 25 percent of the total value of all group assets.'' Temp. reg. section 1.7874-3T(b)(3) is the income test. It says that at least 25 percent of the worldwide enterprise's income must be earned in that location.

An article in *Barron's* said few firms are likely to meet the new, higher standard. Andrew Bary stated, ''The new test stipulates that companies must have 25 percent of employees, profits, and assets in the country of reincorporation. While most big U.S. companies have significant international exposure, few likely meet the 25 percent test.''[29] That article cited Robert Willens, a New York-based tax expert, who thought a small number of companies would be able to meet this standard.[30] In particular, a large multinational enterprise may have operations throughout the world, with assets, employees, and income earned in dozens of countries. In most cases, it seems unlikely that such a firm would be able to meet this test, which may be the Treasury Department's intention. However, as we'll see later, at least one firm says it has met this standard as part of a merger with a U.K.-based business.

2010-2012: Ensco, Aon, and Rowan

As mentioned, the current temporary regulations replaced regulations released in 2009. Before the 2012 regulations were released, three U.S.-headquartered firms moved their corporate headquarters to the United Kingdom. Ensco, a Texas-based drilling services firm, moved its headquarters to London in 2010.[31] A Chicago-based insurance firm, Aon, announced its plans to move in January 2012.[32] Rowan, a Texas-based contract drilling firm, announced its plan to move its headquarters to London in February 2012.[33] All three firms completed their moves before the Treasury Department released its new, more stringent regulations in June 2012.

In all three cases, the firms were careful to distinguish their activities from the corporate inversions that took place in the late 1990s and the early 2000s. In the earlier corporate inversions, those firms said their moves were motivated by tax objectives, and each was careful to state that its inversion would have no impact upon how the firm was actually managed or where senior management would reside. In contrast, the three firms that left for the U.K. between 2010 and 2012 said they were doing so for both operational and tax purposes. All said they would be managed from their new

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[26] *Id.*

[27] *See Fed. Reg.*, Vol. 77, No. 113 (June 12, 2012).

[28] *Id.*

[29] Andrew Bary, ''Uncle Sam Gets Tough on Tax-Domicile Changes,'' *Barron's* (June 12, 2012), p. 21.

[30] *Id.*

[31] *See* Ensco's letter to its shareholders, written by Chairman of the Board Daniel W. Rabun (Nov. 20, 2009), which is included in its merger prospectus, *available at* http://www.enscous.com/Theme/Ensco/files/docs_financial/Ensco%20Special_Proxy_Statement.pdf.

[32] *See* Aon Corporation's SEC filing, Schedule DEFM 14A (Feb. 6, 2012).

[33] *See* ''Rowan Announces Proposed Change in Corporate Structure'' (Feb. 28, 2012), *available at* http://www.rowancompanies.com/fw/main/default.asp?DocID=46&reqid=1666583.

home in the United Kingdom. Ensco was careful to say that is was ''redomiciling'' its corporate headquarters to the United Kingdom, avoiding the words ''corporate inversion.'' I will continue to use the word ''redomiciling'' to discuss the actions of Ensco, Aon, and Rowan.

In its prospectus and letter to its shareholders, Ensco explained it was redomiciling to manage its business operations more effectively.[34] To do this, a small group of senior officers would move their offices to London. In announcing its actions, the firm emphasized that the majority of its drilling activities were outside the United States, and that the firm generated much of its revenue from operations in the Mideast, Africa, and the North Sea. Moving to London would give senior management easier access to those overseas operations. Corporate executives could travel to those sites more easily from London and would be able to communicate with local managers during normal working hours. Ensco also said the move would improve its perception as an international firm and give it improved access to potential European investors.

Though the move was not taking place exclusively for tax objectives, the firm cited several tax advantages for relocating. Ensco's prospectus/proxy statement said its move to the U.K. would:

> locate us in a country with a stable and developed legal regime with established standards of corporate governance, the rights of shareholders, a favorable tax regime, and an established network of tax treaties; and allow us to potentially achieve a global effective tax rate comparable to our global competitors.[35]

Though Ensco completed redomiciling after the 2009 regulations were released, it was careful to demonstrate that it met the substantial business presence test as defined in the 2006 temporary regulations. Its prospectus stated that between 2006-2008 more than 10 percent of its income, assets, and revenue were generated in the United Kingdom.[36] Ensco also cited the 2009 temporary regulations to support its position that it had a substantial business presence there. There are five factors mentioned in the 2009 regulations, and it argued that four of those five factors supported its position that it had a substantial business presence in the United Kingdom. Ensco said it had a long business presence in the United Kingdom, it had substantial managerial activities there, its employees in the United Kingdom had significant managerial responsibilities, and that its activities in the United Kingdom were an important element in the firm's strategy. Ensco acknowledged that few of its shares were owned by U.K. residents, which was the fifth factor identified in the 2009 temporary regulations, but said this could increase with the relocation and improved visibility there.

Aon is an insurance company formerly headquartered in Chicago. It announced plans to relocate its headquarters to London in January 2012, and its shareholders approved that move in March 2012.[37] Like Ensco, Aon cited operational reasons for redomiciling to London, arguing the move would put it in a better position to grow in Europe and other overseas markets.[38] The firm also said the relocation would give it improved access to financial markets and other insurance companies, such as Lloyd's of London.[39] Aon also said it was planning to move some of its senior officers from Chicago to London.[40]

But in addition to the operational benefits, Aon cited tax reasons for relocating. As Ensco also noted, Aon said the United Kingdom's move to a territorial tax system, which in general does not tax profits earned abroad, was an advantage to being headquartered there. A territorial tax system would give the firm easier access to $300 million in cash earned overseas, which it could repatriate to the United Kingdom without incurring further taxes.[41] Also, the relocation would benefit its tax rate, which it predicted would fall from 30 percent to 26 percent.[42]

While Ensco cited the 2006 temporary regulations to support its position that it had a substantial business presence in the United Kingdom, Aon did not cite the prior regulations. However, it said that in the opinion of its tax counsel, McDermott Will & Emery LLP, the 7874 regulations should not be applied toward its relocation.[43] Aon acknowledged that this opinion did not provide assurance that the IRS would not challenge its position that it had a substantial business presence in the United Kingdom, and could perhaps move to invalidate the relocation. As Wells wrote:

> Again, the proxy statement indicated that tax counsel recognized there is no clear safe harbor

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[34]*See* Ensco's merger prospectus, pp. 3-4, *available at* http://www.enscous.com/Theme/Ensco/files/docs_financial/Ensco%20Special_Proxy_Statement.pdf.

[35]*Id.* at 13.

[36]*Id.* at 41.

[37]Becky Yerak, Emily Bryson York, and Kathy Bergen, ''Aon Will Lower Tax Burden in Moving Headquarters to London,'' *Chicago Tribune*, Jan. 14, 2012, *available at* http://articles.chicagotribune.com/2012-01-14/business/ct-biz-0114-aon-moving—20120114_1_aon-center-aon-ceo-aon-corp; Yerak, ''Aon Shareholders Approve Headquarters Move to London,'' *Chicago Tribune*, Mar. 17, 2012, *available at* http://articles.chicagotribune.com/2012-03-17/business/ct-biz-0317-aon-board-20120317_1_aon-center-aon-corp-chief-executive-pat-ryan.

[38]*See* Aon Corporation's SEC filing, Schedule 14A (Feb. 6, 2012), p. 15.

[39]*Id.*

[40]*Id.* at 2-3.

[41]*Id.* at 15-16.

[42]Yerak, York, and Bergen, *supra* note 37.

[43]*See* Aon Corporation's SEC filing, Schedule 14A (Feb. 6, 2012), p. 62.

or other direct guidance on the substantial business presence test. Despite that uncertainty, tax counsel was still able to include that Aon should satisfy the substantial business presence standard with the consequence that the anti-inversion ''surrogate parent'' provisions of section 7874 should not apply to the merger.[44]

The drilling services firm Rowan, formerly based in Houston, also relocated to London in the first half of 2012. Its rationale and objectives were quite similar to Ensco's and Aon's. In February 2012 it announced that its board of directors had approved its plan to transfer its corporate headquarters to the United Kingdom.[45] It completed its move to London in May 2012.[46]

Like Ensco and Aon, Rowan also said its move to the United Kingdom would help it manage the firm more effectively. A press release announcing its actions cited four benefits to relocating. Rowan said relocating would improve access to the firm's customers, enhance its ability to expand in the North Sea and other locations, improve the perception that Rowan is a global contract driller, and allow Rowan to achieve a tax rate comparable to its global competitors, the majority of which it said were domiciled outside the United States.[47]

However, unlike Ensco and Aon, Rowan did not announce plans to move its executive management overseas. In an SEC filing, it explained that some of the firm's managers were already located there. It said:

> Rowan has made a significant strategic shift towards global markets over the past three decades, and already had significant operation in the U.K., in Aberdeen. Senior members of the company's team reside in the U.K., overseeing approximately 750 employees, who manage operations in the North Sea, and will manage future operations in Egypt. The company also had U.K.-based directors on its Board for many years, and will now hold all quarterly Board meetings and its annual general meeting of shareholders in the U.K.[48]

When the firm's decision was announced, its CEO, W. Matt Ralls, said:

> With this change in our structure we formally recognize that the base of operations we first established in the U.K. more than three decades ago is now a central and efficient location from which we manage the markets that will be our largest source of revenue this year.[49]

Concerning taxes, Rowan declined to predict a tax rate, but the firm said moving abroad would help it achieve a tax rate similar to other firms domiciled outside the United States. Further, Rowan seemed to imply that it needed to take this action to keep pace with other drilling services firms such as Transocean, Ensco, Nabors Industries, and Noble Corp., which had already relocated abroad. Its press release announcing the relocation said: ''Longer term, it also enables us to be competitive with the global tax rate of our peers, most of which have already changed domiciles or were domiciled outside the U.S.''[50]

Like Aon, Rowan cited its tax advisers' opinion that the relocation to the United Kingdom should not be subject to section 7874. Wells wrote:

> In considering whether the naked inversion transaction would withstand attack under section 7874, the proxy statement said that tax counsel recognized that no clear safe harbor or other direct guidance existed regarding the substantial business presence test. Despite that uncertainty, tax counsel was still able to conclude that Rowan should satisfy the substantial business presence standard with the consequence that the anti-inversion surrogate parent provisions of section 7874 should not apply to the merger.[51]

At this time, it does not appear the IRS has taken any actions to invalidate the headquarters relocations of Ensco, Aon, or Rowan.

Mergers

Shortly after the 2012 temporary regulations were released, Robert Willens said he believed that few U.S. firms would be able to meet the three 25 percent substantial business presence tests, covering employees, assets, and income. According to Willens, Aon only generated 15 percent of its revenue in the United Kingdom.[52] Since those regulations were released, it appears that some firms are taking a different approach to headquarters relocations and are moving abroad as part of a corporate merger. In at least one case a merger appears to have helped a firm meet the 25 percent substantial business presence test.

As mentioned, section 7874 has three tests, and all must be met for a firm to be subject to that statute. The third test measures ownership before and after the headquarters relocation. If 80 percent or more of the

[44]Bret Wells, ''What Corporate Inversions Teach About International Tax Reform,'' *Tax Notes Int'l*, July 26, 2010, p. 281.

[45]*See* ''Rowan Announces Proposed Change in Corporate Structure — to Relocate to UK'' (Feb. 28, 2012), *available at* http://www.energy-pedia.com/news/general/new-149332.

[46]Rowan, Form 8-K, filed May 4, 2012.

[47]*See supra* note 45.

[48]*See* the Rowan Companies website, *available at* http://www.rowancompanies.com/Investor-Relations/Redomestication-288.html, explaining the company's redomestication.

[49]*Id.*

[50]*See supra* note 33.

[51]Wells, *supra* note 44.

[52]Bary, *supra* note 29.

shares remain in the same hands, the firm is still considered a U.S.-headquartered enterprise. If between 60 to 80 percent of the shares are owned by the same shareholders, the firm's move is respected, but the exit tax connected with the departure might be increased. This exit tax is also known as the inversion gain, which is triggered by the expatriation to another country.[53] And if fewer than 60 percent of the remaining shares are owned by the same parties, the firm is considered a foreign entity, and it is not subject to any higher taxes associated with the relocation. The 2012 Treasury regulations addressed only the substantial business presence test and did not affect the ownership tests, which are included in the Internal Revenue Code, not just the Treasury regulations. So even if a firm does not have a substantial business presence in another country, it may relocate abroad successfully if 20 percent or more of its shares change ownership at the time of a corporate merger.

Financial Times noted this trend in August 2013. An article said:

> A growing number of US companies are set to save hundreds of millions of dollars in tax by relocating to Europe after completing takeovers on the continent. Some of the biggest mergers and acquisitions so far in 2013 have involved so called ''tax inversions'' — where a US acquirer shifts overseas, to Europe in particular, to pay a lower rate.[54]

Table 2 identifies firms that have merged since 2012 and selected a European site as the new worldwide headquarters of the combined enterprise. In most situations a U.S. firm acquired a European firm and selected the European site as the post-merger worldwide headquarters, although in many cases the U.S. firm's operations were significantly larger than the merger partner's. However, in two cases firms selected a new headquarters in the Netherlands, although neither was headquartered there in the past. But in all cases the firms relocated abroad, and likely reduced their income tax expense and avoided the complexities of the U.S. worldwide tax system, which can make it more difficult for firms to transfer cash to the parent company without incurring additional taxes. According to *Financial Times*: ''While tax saving has not been the main driver of these deals, or planned relocations, M&A advisers say the number of companies seeking to redomicile outside the US after a takeover is rising.''[55]

Applied Materials/Tokyo Electron Ltd.

Applied Materials supplies manufacturing equipment to the semiconductor, flat panel display, and solar photovoltaic industries. It is headquartered in Santa Clara, Calif. Its annual revenue was $7.2 billion in 2012, and it employs approximately 15,000 people. Tokyo Electron Ltd. is headquartered in Tokyo, and it also produces semiconductor manufacturing equipment. Its revenue was $5.4 billion in 2012, and it employs approximately 12,000 people.[56] On September 24, 2013, Applied Materials announced a proposed merger with Tokyo Electron Ltd.[57] The merger has not been approved by regulatory agencies or by the firms' shareholders, and thus it has not been completed.

Applied Materials says it is a merger of equals. According to its SEC filing, 68 percent of the shares will be owned by former shareholders of Applied Materials, and 32 percent of the shares will be owned by former shareholders of Tokyo Electron Ltd.[58] When the merger was announced, Applied Materials said the combined firm would have operating headquarters in Santa Clara and Tokyo, but for legal and tax purposes the firm would be incorporated in the Netherlands.[59] Since the Applied Materials shareholders will own 68 percent of the merged enterprise, it appears U.S. tax authorities will respect the merged firm's new domicile but may deny it some tax attributes that would reduce the firm's exit tax.

In a conference call announcing the merger, Robert Halliday, the CFO of Applied Materials, said the firm was projecting that its tax rate would drop from 22 percent to 17 percent as a result of the merger.[60] He also said that the new structure would improve the company's ability to access its cash around the world, and thus give it increased flexibility to declare dividends and repurchase shares.[61] In 2011 Applied Materials earned over $2 billion, so a 5 percent tax reduction would save the firm approximately $100 million per year, not including profits earned by Tokyo Electron Ltd.

Perrigo/Elan

On July 29, 2013, Michigan-based pharmaceuticals firm Perrigo agreed to purchase Irish-based biotechnology firm Elan for $8.6 billion.[62] Perrigo produces a variety of over-the-counter and low-cost, generic medications, such as cold remedies, allergy treatments, and infant formula. Elan is a biotechnology company focused on cutting-edge breakthroughs in diseases such as multiple sclerosis. Perrigo and Elan shareholders

[53]Section 7874(a)(2)(B)(i)-(iii).

[54]Anousha Sakoui and James Politi, ''Europe's Lower Tax Rates Lure US Groups,'' *Financial Times* (Aug. 13, 2013), p. 11.

[55]*Id.*

[56]*See* Applied Materials Inc. SEC 425 (Sept. 24, 2013), p. 7.

[57]*See* Applied Materials Inc. SEC 8-K (Sept. 24, 2013), p. 1.

[58]*Id.* at 2.

[59]*Id.* at 16.

[60]*See supra* note 56, conference call with investors, p. 10.

[61]*Id.*

[62]*See* Perrigo, SEC 8-K (July 29, 2013), at p. 108.

Table 2. Merging Firms Selecting European Headquarters (2012-2014)

Merging Firms	Merger Date	Merged Firm's New Home	Estimated Annual Tax Savings	Ownership of Merged Firm
Applied Materials/Tokyo Electron Ltd.	Merger announced September 2013. Not completed.	Netherlands	Tax rate expected to drop from 22% to 17%.	Applied Materials shareholders will own 68% of the merged business, and Tokyo Electron shareholders will own 32%.
Perrigo/Elan	Completed December 2013.	Ireland	Tax rate expected to drop from 30% to the high teens.	Perrigo shareholders own 71% of the combined firm, and Elan shareholders own 29%.
Actavis/Warner Chilcott	Completed October 2013.	Ireland	Tax rate expected to drop from 28% to 17%.	Actavis shareholders to own 77% of the combined firm, and Warner Chilcott shareholders will own 23%.
Omnicom/Publicis	Announced July 2013. Aiming to complete merger Q2 2014.	Netherlands	$80 million annually, but the firm said the move was not being made for tax reasons.	Omnicom shareholders will own 49.36% of the firm, and Publicis shareholders will own 50.64%.
Liberty Global/Virgin Media	Completed June 2013.	United Kingdom	Said relocation to U.K. had financial benefits, but did not quantify.	Liberty Global owns 64% and Virgin Media 36% of the merged firm. However, the firm says it meets the substantial business presence test, and it is relying on that test to redomicile its headquarters.
Eaton/Cooper Industries	Completed November 2012.	Ireland	Tax savings estimated to be $160 million annually.	Eaton shareholders own 73% of the merged firm, and Cooper shareholders 27%.
Pentair/Tyco Flow	Completed September 2012.	Switzerland	No estimate available.	Tyco Flow owns 52.5%; Pentair owns 47.5%.
Jazz Pharmaceuticals/ Azur Pharma Ltd.	Completed January 2012.	Ireland	No estimate available.	Jazz Pharmaceuticals owned just under 80% of the shares, and Azur shareholders slightly more than 20% of the merged firm's shares.

both approved the merger in November 2013, and the transaction was completed in December 2013.[63]

Current shareholders of Perrigo own 71 percent of the combined enterprise, while Elan's shareholders own 29 percent of the new firm.[64] According to SEC filings, the firm will be managed by Perrigo's current executive team, but the firm will be legally headquartered in Dublin, Ireland. Since Perrigo's shareholders will own 71 percent of the merged enterprise, it appears the IRS will respect the firm's relocation, but not allow it to use tax credits and NOLs that could reduce the firm's inversion gain.

According to Perrigo, the merger will allow the firm to reduce its combined cost structure and income tax rate. Perrigo stated in an SEC filing:

> The combination is expected to result in more than US$150 million of recurring after-tax annual operating expense and tax savings. These synergies are expected to create strong pro forma cash flows to support an investment grade credit profile. Certain of these synergies result from the elimination of redundant public company costs while optimizing back-office support and the global R&D functions. Additionally, tax savings are expected to arise from the combined company

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[63] *See* ''Perrigo PLC completes acquisition of Elan PLC,'' *available at* http://perrigo.investorroom.com/2013-12-18-Perrigo-Company-plc-Completes-Acquisition-of-Elan-Corporation-plc.

[64] *Id.* at 10.

> being incorporated in Ireland with organizational, operations and capitalization structures that will enable the combined company to more efficiently manage its global cash and treasury operations.[65]

When the merger was announced, Perrigo CEO Joseph Papa told *The Wall Street Journal* he expected the firm's tax rate would drop from 30 percent to the high teens.[66] *Financial Times* estimated that the tax savings would total $118 million per year.[67] Thus, the tax savings represent the largest portion of the $150 million and tax and operating expense reduction.

Actavis/Warner Chilcott

On May 19, 2013, New Jersey-based pharmaceutical firm Actavis announced its $8.5 billion acquisition of the Irish-based pharmaceutical firm Warner Chilcott.[68] The merger was completed in October 2013. Merger documents filed with the SEC state:

> Immediately following the transaction, based on the number of Actavis and Warner Chilcott shares outstanding as of the record date, the former stockholders of Actavis are expected to own approximately 77 percent of New Actavis and the remaining approximately 23 percent of New Actavis is expected to be owned by the former shareholders of Warner Chilcott.[69]

Based on this, it appears the merged firm can redomicile its headquarters overseas, but it may not be able to use NOLs and other tax credits to reduce exit taxes.

Actavis is now legally headquartered in Ireland, but the firm's administrative headquarters remains in the United States. According to its SEC filing, ''The New Actavis senior management team after the acquisition and the merger is expected to be the same as the current senior management team of Actavis.''[70] Their SEC filing did not discuss the possibility of moving senior management overseas, a risk factor discussed by other firms relocating senior management.

The firm saw significant tax and financial benefits to being domiciled in Ireland. Its SEC filing stated:

> Incorporating New Actavis in Ireland will result in significantly enhanced global cash management and flexibility and associated financial benefits to the combined enterprise. These benefits include increased global liquidity and free global cash flow among the various entities of the combined enterprise without negative tax effects. Because of these benefits, we expect that New Actavis will be able to operate its businesses more easily and at lower cost, and also will have a lower worldwide effective tax rate than it would have otherwise.[71]

According to *Financial Times,* its tax rate should drop from 28 percent to 17 percent, and it will save $150 million dollars over the next two years from this action.[72]

While Actavis said it believed it should be able to redomicile to Ireland, it could not guarantee its move will not be challenged by the IRS, since the law's provisions have not been tested. Its SEC filing said:

> The Actavis stockholders are expected to own less than 80 percent (by both vote and value) of the shares in New Actavis after the transaction by reason of their ownership of shares of Actavis stock. As a result, under current law, New Actavis is expected to be treated as a foreign corporation for U.S. federal tax purposes. We cannot assure you that the IRS will agree with the position that the ownership test is satisfied, however. There is limited guidance regarding the section 7874 provisions, including the application of the ownership test.[73]

Because more than 20 percent of its shares will change ownership as a result of the merger, the firm will lose tax attributes that could reduce its exit tax. Its SEC filing said:

> Based on the limited guidance available, Actavis currently expects that following the transaction, this limitation will apply and as a result, Actavis currently does not expect that it or its U.S. affiliates will be able to utilize their U.S. tax attributes to offset their U.S. taxable income, if any, resulting from certain specified taxable transactions.[74]

The firm also acknowledged that tax laws can change, and that it could not guarantee U.S. tax authorities would permanently recognize it as an Irish firm. Actavis wrote:

> In addition, there have been legislative proposals to expand the scope of U.S. corporate tax residence and there could be prospective or retroactive changes to section 7874 or the U.S. Treasury regulations promulgated could adversely affect New Actavis' status as a foreign corporation for U.S. federal income tax purposes.[75]

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[65] *Id.* at 11.

[66] Jonathan D. Rockoff, ''Perrigo to Buy Elan for $8.6 Billion,'' *Wall St. J.* (July 29, 2013), *available at* http://online.wsj.com/news/articles/SB10001424127887324354704578634652886726058.

[67] Sakoui and Politi, *supra* note 54.

[68] *See* the DEFM 14A (Definitive Proxy Statement Related to a Merger) of Actavis (Aug. 1, 2013), p. 70.

[69] *Id.* at 12.

[70] *Id.* at 23.

[71] *Id.* at 9.

[72] Sakoui and Politi, *supra* note 54.

[73] *See supra* note 68, at 35-36.

[74] *Id.* at 36.

[75] *Id.*

Omnicom/Publicis

On July 29, 2013, advertising firms Omnicom and Publicis announced their merger. Omnicom and Publicis are currently the second and third largest advertising firms in the world. Their merger would create the world's largest advertising business. As a result, the merger requires the approval of regulatory bodies in many countries, and it has not yet been completed. They are currently projecting that it will be completed in the second quarter of 2014.[76]

Omnicom has been based in New York City, and Publicis has been headquartered in Paris. The firms said this is a merger of equals. After special dividends are paid, the shareholders of Publicis will own 50.64 percent and Omnicom shareholders will own 49.36 percent.[77] Thus, the merger does not appear to be subject to section 7874, and it can redomicile without losing any tax attributes. Unlike several other companies mentioned in this article, these firms did not identify application of section 7874 as a risk.

According to its SEC filings, the firm will have operational headquarters in Paris and New York, but the firm will be registered in Amsterdam, in the Netherlands.[78] When the merger was announced, executives said this was done for operational reasons, rather than tax purposes. Publicis CEO Maurice Levy said: ''A U.S. headquarters would have given the impression that Publicis had been absorbed by Omnicom. With a French headquarters, the impression would have been the other way around.''[79] While the new headquarters in the Netherlands may not have been selected for tax reasons, locating there may save the firm approximately $80 million per year.[80]

Liberty Global/Virgin Media

Broadband Internet and telephone service provider Liberty Global announced its acquisition of Virgin Media in February 2013. The merger was completed in June. Liberty Global was headquartered in Colorado, and Virgin Media was based in the United Kingdom. Post-merger, Liberty Global's shareholders own approximately 64 percent of the merged enterprise's shares and 74 percent of the voting shares. Virgin Media's shareholders owned 36 percent of shares and 26 percent of voting shares.[81]

The merged enterprise selected London as its new corporate home. The firm saw both operating and tax benefits to relocating to the United Kingdom. From an operating perspective, the firm said:

> In evaluating the redomiciliation, the Virgin Media board of directors took into account that a substantial majority of the combined business would be based in Europe (with the largest business being in the U.K.), that very little of the business would be based in the United States, and that there are substantial structural and fiscal challenges associated with operating an enterprise with a very limited U.S. business through a U.S. holding company structure.[82]

However, there are also tax benefits to relocating, because the United Kingdom has lower income tax rates and has transitioned toward territorial tax policies. In an SEC filing, Liberty Global said it believed relocating to the United Kingdom would lower its tax rate in the next few years, but it could not permanently guarantee that outcome. It said:

> New Liberty Global believes that the mergers should improve the combined group's ability to maintain a competitive worldwide effective corporate tax rate. New Liberty cannot give any assurance, however, as to what its effective tax rate will be after the merger because of, among other things, uncertainty regarding the tax policies of the jurisdictions where it operates.[83]

The firm also noted that future tax rates and policies in both the United States and the United Kingdom are subject to change.[84] In an interview with *Financial Times*, Liberty Global CEO Mike Fries said relocating to the United Kingdom had financial benefits, but he declined to comment on the tax impact.[85] In a separate article, *Financial Times* said: ''Liberty Global's $23 billion acquisition of Virgin Media will allow it to relocate to the UK and it will pay a 21 percent tax rate.''[86]

The firm appears to be able to relocate its headquarters based on the change in ownership. However, the firm believes it meets the 25 percent substantial business presence test announced in the 2012 regulations.

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[76] *See* Sam Schechner, ''Review Pushes Back Publicis-Omnicom Merger,'' *Wall St. J.* (Nov. 21, 2013), *available at* http://online.wsj.com/news/articles/SB10001424052702304337404579212154031928542.

[77] *See* the SEC 8-K filing of Omnicom (July 27, 2013), p. 2.

[78] *Id.* at 190.

[79] William Horobin and Ruth Bender, ''Publicis, Omnicom Had Eyed U.S. Headquarters,'' *Wall St. J.* (July 31, 2013), *available at* http://online.wsj.com/news/articles/SB10001424127887323681904578639573465093536.

[80] Sakoui and Politi, *supra* note 54.

[81] *See* Schedule DEFM 14A for Liberty Global (May 1, 2013), p. 74.

[82] *Id.* at 102.

[83] *Id.* at 49.

[84] *Id.*

[85] David Gelles and Andrew Edgecliffe-Johnson, ''Liberty Global Confirms Virgin Media Bid,'' *Fin. Times,* (Feb. 6, 2013), *available at* http://www.ft.com/intl/cms/s/0/3662103a-6fe7-11e2-8785-00144feab49a.html#axzz2nws7UBxB.

[86] Sakoui and Politi, *supra* note 54.

Departing under the substantial business presence test is preferable to the change in ownership test, since the firm does not lose any tax credits. Liberty Global's SEC filing said:

> Under Section 7874 of the Code, New Liberty Global will be treated as a U.S. corporation for U.S. federal income tax purposes unless the New Liberty Global ''expanded affiliated group'' is treated as having ''substantial business activities'' in the U.K. For this purpose, ''expanded affiliated group'' generally includes Liberty Global and Virgin Media and their respective subsidiaries, and ''substantial business activities'' generally means at least 25 percent of employees (by number and compensation), assets and gross income of the New Liberty Global expanded affiliated group are based, located and derived, respectively, in the U.K.[87]

Further, the firm wrote:

> New Liberty Global expects to satisfy this 25 percent test because substantially all of the operations of Virgin Media occur in the U.K., and some of the operations of Liberty Global occur in the U.K. (with its remaining operations occurring throughout Europe and Latin America), and New Liberty Global will continue these operations. We caution, however, that the satisfaction of the 25 percent test generally is determined at the closing of the merger and there could be adverse changes to the relevant facts and circumstances.[88]

Finally, the firm cautioned that U.S. tax laws could change. It said:

> In addition, there have been legislative proposals to expand the scope of U.S. corporate tax residence and there could be changes to Section 7874 of the Code or the Treasury Regulations promulgated thereunder that could result in New Liberty Global being treated as a U.S. corporation.[89]

Eaton/Cooper Industries

Eaton is a diversified power management firm providing electrical products to a variety of industries. It was formerly headquartered in Cleveland, Ohio. In May 2012 it announced its takeover of Cooper Industries, which was headquartered in Dublin, Ireland. The merger was completed in November 2012. As previously mentioned, Cooper Industries was a U.S.-based firm that inverted to Bermuda in 2001 and that later moved its headquarters to Ireland. The merged firm will be managed from the United States.[90] After the merger Eaton's former shareholders owned 73 percent of the merged enterprise, and Cooper Industries' shareholders owned 27 percent of the combined firm.[91]

Eaton said the tax savings were extremely important considerations in their decision to acquire Cooper, and that without them they may not have pursued the acquisition. Their SEC filing said:

> The transaction was not economically feasible without incorporation outside the United States because of material competitive advantages currently enjoyed by Cooper as a result of its non-United States incorporation. Amongst these advantages are greater flexibility and lower cost of cash management, an enhanced ability to grow faster through organic growth and acquisitions, as well as a lower worldwide effective tax rate. Loss of these existing Cooper competitive advantages would have caused a large dissynergy that would have prevented the acquisition from occurring.[92]

Further they stated:

> Incorporating New Eaton in Ireland will result in significantly enhanced global cash management and flexibility and associated financial benefits to the combined enterprise. These benefits include increased global liquidity and free global cash flow among the various entities of the combined enterprise without negative tax effects. In addition, the Irish rules surrounding the taxation of controlled foreign corporations are much more typical of the rules found in most developed countries compared to the rules found in the United States that are competitively adverse. As an example, the Irish rules surrounding controlled foreign corporations allow a number of active inter-company business operations to occur without negative tax effect. Because of these benefits, we expect that New Eaton will be able to operate its businesses more easily and at lower cost, and also will have a lower worldwide effective tax rate than it would have otherwise.[93]

Eaton also pointed out that Ireland was a member of the EU and had an extensive network of tax treaties.

Eaton believes it has met the test to exit the U.S. tax system but acknowledged it could not guarantee this permanently. It said: ''As a result, under current law, New Eaton should be treated as a foreign corporation for U.S. federal income tax purposes. However, it is

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[87]*See* Schedule DEFM 14A for Liberty Global (May 1, 2013), p. 48.

[88]*Id.*

[89]*Id.* at 48.

[90]*See* Schedule DEFM 14A for Eaton (Sept. 14, 2012), p. 99, *available at* http://www.eaton.com/ecm/groups/public/@pub/@eaton/@corp/documents/content/pct_390968.pdf.

[91]*Id.* at 13.

[92]*Id.* at 7.

[93]*Id.*

possible that there could be a change in law under section 7874 or otherwise that could adversely affect New Eaton's status as a foreign corporation.''[94] Further, it noted that it may not be able to use all of its tax credits to reduce the inversion gain due as part of the relocation. It said:

> Following the acquisition of a U.S. corporation by a foreign corporation, section 7874 can limit the ability of the acquired U.S. corporation and its U.S. affiliates to utilize U.S. tax attributes such as net operating losses to offset U.S. taxable income resulting from certain transactions.[95]

Barron's estimated that the combined firm will save approximately $160 million per year as a result of its decision to locate its headquarters in Dublin.[96]

Pentair/Tyco Flow

Pentair and Tyco Flow merged in September 2012. Pentair is an industrial firm producing water and fluid treatment equipment, industrial valves, and pumps, and it was formerly headquartered in Minneapolis, Minn. Tyco Flow was the flow control instruments business spun off from Tyco International and immediately merged with Pentair. The merged firm will be headquartered in Switzerland.[97] But for operating purposes the firm will be headquartered and managed from the United States. According to its SEC filing: ''After the Transactions are complete, the current executive officers of Pentair will be the executive officers of New Pentair and will manage the combined business.''[98]

As part of the merger, the former shareholders of Pentair will own 47.5 percent of merged business, and the former shareholders of Tyco Flow will own 52.5 percent.[99] Since less than 60 percent of the shares will be owned by former shareholders of Pentair, there appear to be no limitations on its move abroad, and its merger document filed with the SEC makes no reference to tax risks associated with IRS challenges under section 7874. The SEC filing does note that the firm will be a Swiss corporation and this may affect current Pentair shareholders. The SEC filing noted:

> New Pentair's status as a Swiss Corporation may limit New Pentair's flexibility with respect to certain aspects of capital management and may cause New Pentair to be unable to make distributions without subjecting New Pentair's shareholders to Swiss withholding tax.[100]

Jazz Pharmaceuticals/AzurPharma Ltd.

In September 2011, Jazz Pharmaceuticals, which was based in Palo Alto, Calif., announced its purchase of the privately held Irish pharmaceuticals firm AzurPharma Ltd. The acquisition was completed in January 2012. According to its SEC filings the shareholders of AzurPharma own just over 20 percent of the combined enterprise, and shareholders of Jazz Pharmaceuticals own slightly less than 80 percent of the merged firm.[101] While the firm's new headquarters is in Dublin, the firm is managed by senior management in the United States. According to its SEC filing:

> Pursuant to the merger agreement, the officers of New Jazz will be designated by Jazz Pharmaceuticals. As of the date of the proxy statement/prospectus, it is expected that the executive officers of New Jazz following the completion of the merger will initially be the same persons currently serving as executive officers of Jazz Pharmaceuticals, with Bruce C. Cozadd, the current Chairman and Chief Executive Officer of Jazz Pharmaceuticals, serving as New Jazz's Chairman and Chief Executive Officer.[102]

There was no discussion of moving senior management overseas, which is generally identified as a risk by firms contemplating such actions.

However, Jazz said there was a risk the IRS would challenge its relocation. Its SEC filing said: ''Although New Jazz will be incorporated in Ireland, the IRS may assert that it should be treated as a U.S. corporation (and, therefore, a U.S. tax resident) for U.S. federal tax purposes pursuant to section 7874 of the code.''[103] Jazz said it believed that it satisfied the ownership test under section 7874, and that its headquarters relocation to Ireland should be respected. However, it said it could not guarantee that the IRS would agree with its position, writing:

> It is possible that the IRS could disagree with the position that the ownership test is satisfied and assert that section 7874 of the code applies to treat New Jazz as a U.S. corporation following the merger. There is limited guidance regarding the code section 7874 provisions, including the application of the ownership test described above. Moreover, new statutory and/or regulatory provisions under section 7874 of the code or otherwise could be enacted that adversely affect New Jazz's status as a foreign corporation for U.S. federal tax purposes, and any such provisions could have

[94] *Id.* at 33.

[95] *Id.* at 32.

[96] Bary, *supra* note 29.

[97] *See* Schedule DEFM 14A of Pentair (Aug. 3, 2012), p. 179.

[98] *Id.* at 5.

[99] *Id.* at 4.

[100] *Id.* at 43.

[101] *See* Schedule DEFM 14A of Jazz Pharmaceuticals (Nov. 10, 2011), p. 48.

[102] *Id.* at 12.

[103] *Id.* at 48.

retroactive application to NewJazz, Jazz Pharmaceuticals, their respective shareholders, and/or the merger.[104]

Like several other firms, Jazz noted that section 7874 would prevent it from using the tax attributes to reduce its exit tax. It said: ''Following certain acquisitions of a U.S. corporation by a foreign corporation, section 7874 of the code limits the ability of the acquired U.S. corporation and its U.S. affiliates to utilize U.S. tax attributes such as net operating losses to offset U.S. taxable income resulting from certain transactions.''[105] Later it commented: ''As a result, it is not currently expected that Jazz Pharmaceuticals or its U.S. affiliates will be able to utilize their U.S. tax attributes to offset their U.S. taxable income, if any, resulting from certain taxable transactions following the merger.''[106]

2014 Section 7874 Regulations

As mentioned, on January 17, 2014, the Treasury Department released additional Treasury regulations governing section 7874.[107] These regulations focused on how the percentage of ownership test is calculated, rather than the substantial business presence test, which was the focus of the 2006, 2009, and 2012 regulations. In some situations these new regulations can affect the calculation of how many shares have changed hands when a domestic firm is acquired.

When section 7874 was enacted, Congress specifically stated that it would disregard some transactions when determining whether an ownership test was met. Congress said if an initial public offering of an overseas corporation took place as part of the acquisition of a U.S. firm, the stock raised would be disregarded when determining whether an ownership test was met.[108] Notice 2009-78 later expanded on that principle and said the IRS would also apply this rule on private sales of stock, or similar transactions. These new Treasury regulations are a follow-up to that notice, and they explain in more detail how this principle will be applied.

The preamble to the new regulations states:

> Under the statutory public offering rule of section 7874(c)(2)(B), stock of the foreign acquiring corporation is not taken into account for purposes of the ownership fraction if the stock is sold in a public offering related to the acquisition. Absent the statutory public offering rule, the purposes of section 7874 could be avoided by having the acquiring foreign corporation issue stock to the public in exchange for cash in order to reduce the ownership fraction while not significantly altering the manner in which the domestic entity did business before the inversion transaction. Consistent with the notice, the IRS and Treasury Department believe that stock of the foreign acquiring corporation transferred in exchange for certain property in a transaction related to the acquisition, but not through a public offering, presents the same opportunity to inappropriately reduce the ownership fraction. For example, a private placement of the stock of a foreign acquiring corporation in exchange for cash raises the same policy concern that the ownership fraction will be inappropriately reduced by increasing the net assets of the foreign acquiring corporation.[109]

The temporary regulations provide examples in which overseas firms raise funds through private transactions as part of a merger with a domestic firm, and how the percentage of ownership test will be calculated in those circumstances. In general the new rules disregard stock raised in such transactions when calculating the percentage of ownership that has changed hands.

Thus, the new regulations only apply when an international firm is involved in private sales of stock that is connected to the acquisition of a U.S. firm. The law firm Davis Polk & Wardwell LLP evaluated the new regulations and specifically said they would not apply toward some of the mergers discussed in this article. It said:

> Given their narrow focus, the Temporary Regulations generally do not affect inversion transactions involving the combination of a non-U.S. corporation and a U.S. corporation that both are in active operating businesses, like Actavis-Warner Chilcott, Applied Materials-Tokyo Electron and Omnicom-Publicis.[110]

Conclusion

Since 2010 at least 11 U.S.-headquartered firms have moved their headquarters to Europe. Before the release of the June 2012 temporary regulations, three U.S. firms — Ensco, Aon, and Rowan — moved their headquarters to the United Kingdom. In each case the firms took the position that they met the substantial business presence test in the 2009 regulations. Since new temporary regulations were released, eight U.S. firms have moved or plan to move their headquarters from the United States to Europe as part of business mergers. Relocating firms include:

[104] *Id.*

[105] *Id.* at 49.

[106] *Id.*

[107] *See Fed. Reg.*, Vol. 79, No. 12 (Jan. 17, 2014), pp. 3094-3104.

[108] Section 7874(c)(2)(B).

[109] *See supra* note 107, at 3095.

[110] *See* Davis Polk & Wardwell, ''New Regulations Expand Reach of Anti-Inversion Ownership Rules,'' Jan. 17, 2014, *available at* http://www.davispolk.com/new-regulations-expand-reach-anti-inversion-ownership-rules/.

- Three U.S. pharmaceutical firms have merged or are merging with Irish pharmaceutical companies. In each case the firms have selected Ireland as the new corporate home, although it appears that senior management will reside in the United States. Jazz Pharmaceuticals merged with AzurPharma Ltd. in 2011. Actavis purchased Warner Chilcott in 2012. Perrigo planned to complete its merger with Elan before the end of 2013. In each case, the U.S. shareholders own between 70 and 80 percent of the merged enterprise. Thus each firm was able to escape the U.S. tax system, although they may have to pay higher exit taxes as a result of section 7874.

- Two of the mergers involve firms that originally inverted to Caribbean tax havens and subsequently moved to Europe. Both Cooper Industries and Tyco inverted to Bermuda. Cooper Industries later relocated to Ireland, and Tyco International (a spinoff from Tyco) subsequently moved its headquarters to Switzerland. Eaton acquired Cooper Industries in 2012. While the merged firm is managed by senior management in the United States, its tax headquarters is Ireland. Similarly, Pentair purchased Tyco Flow (a spinoff from Tyco International) in 2012. It will also be managed from the United States, but for tax purposes its headquarters will be in Switzerland.

- The Netherlands was the preferred destination for merging firms that selected a new headquarters site for the merged firm. An article in *The Economist* said the Netherlands has very flexible corporate laws, likening it to Delaware, the legal home of many large U.S. firms.[111] Two firms will be legally headquartered there. None of the firms involved was previously headquartered in the Netherlands. U.S.-based Applied Materials is merging with Japanese firm Tokyo Electron Ltd. and will be legally headquartered there. Applied Materials said that lower taxes and easier access to the firm's worldwide cash contributed to its decision. U.S.-based Omnicom is merging with Paris-based Publicis and they also selected the Netherlands as their headquarters. While they said taxes were not the primary reason for their decision to locate there, according to one estimate the merged firm will save $80 million annually by doing so.

- The 2012 temporary regulations may make it more difficult to relocate under the substantial business presence test, but it is not impossible. Liberty Global acquired U.K.-based Virgin Media and says that it now meets the 25 percent employee, assets, and income tests in those regulations. By employing this approach the firm does not risk losing tax attributes that can reduce exit taxes.

- Finally, it appears that headquarters relocations happen more frequently in some industries. As mentioned, there were three pharmaceuticals firms that selected Ireland as the new corporate home. It also appears that headquarters relocations are more common in the oil drilling and exploration business. Noble Corp., Nabors Industries, Transocean, Ensco, and Rowan have all moved their headquarters overseas. Rowan specifically said relocating its headquarters abroad would make it more competitive with its peers, many of whom had already moved their headquarters abroad. Thus competitive pressures within an industry may also motivate firms to consider relocating their worldwide headquarters. ◆

[111]"Here, There and Everywhere," *The Economist* (Feb. 22, 2014), p. 56.