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Inversions to Ireland

An increasing number of US corporate groups are choosing to re-domicile their top holding company in Ireland to, among other reasons, take advantage of better overall tax rates and reduce compliance costs.

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A US corporate group can re-domicile its top holding company in Ireland (commonly referred to as "inverting" or an "inversion") if:

- It has substantial business activities in Ireland (a self inversion).
- It undertakes a strategic acquisition or merger with a foreign company and places the top holding company of the merged group in Ireland, provided generally that the former US company stockholders own less than 80% of the combined equity (a deal-related inversion).

Currently, most inversions are structured as deal-related inversions rather than self inversions because of the US anti-inversion rules in Section 7874 of the Internal Revenue Code (US anti-inversion rules) (see below *US Anti-inversion Rules*).

There are many reasons for a US corporate group to consider an inversion, but the most common ones are to reduce the group's overall corporate tax rate and to escape the complex US tax rules that add to compliance costs (for example, controlled foreign corporation (CFC), transfer pricing and thin capitalization rules). However, inversion transactions are not driven solely by tax considerations and generally there must be a strong business rationale for an inversion.

This article examines the current market trend of deal-related inversions to Ireland, including:

- Cases in which an inversion is possible.
- How inversions are commonly structured.
- Why so many US corporate groups are choosing Ireland.

WHEN IS AN INVERSION POSSIBLE?

In very broad terms, an inversion is worth considering for a US corporate group that has significant foreign operations or revenues, or where there is an expectation that the foreign operations or revenues will grow in the future (either through organic growth by the group itself or assisted by a strategic merger with a foreign company). Tax savings are one reason for an inversion. By moving, at a minimum, foreign profits from the US corporate tax net, the US tax savings that can be achieved in an inversion transaction can be significant. Inversions are not solely tax motivated but reducing financial statement tax rates is often a compelling factor.

However, the decision to re-domicile cannot be taken lightly. An inversion is likely to have substantive consequences for the governance and operations of the US corporate group and it is important to select a jurisdiction that requires the fewest changes while at the same time offering the maximum flexibility.

For a US corporate group, there are a number of issues to think about when considering an inversion, including the tax treatment of stockholders and executives, as well as post-inversion planning opportunities. One of the biggest hurdles is ensuring the transaction does not run afoul of the US anti-inversion rules.

US ANTI-INVERSION RULES

Very generally, the US anti-inversion rules apply to a deal-related inversion in which a US company (US Co) and a foreign company (Foreign Co) combine under a new foreign top holding company (Foreign HoldCo) and after the acquisition:

- At least 60% of Foreign HoldCo stock is, by vote or value, owned by former US Co stockholders (the Stockholder Percentage Test).
- The expanded affiliated group of which Foreign HoldCo is part does not have "substantial business activities" in Foreign HoldCo's jurisdiction (the Substantial Business Activities Test).

The Stockholder Percentage Test

In a deal-related inversion, the Stockholder Percentage Test in the US anti-inversion rules is overcome if after the transaction less than 60% of the stock in Foreign HoldCo is owned by former US Co stockholders. However, an inversion that fails to overcome the Stockholder Percentage Test will not be subject to the US anti-inversion rules if the Substantial Business Activities Test is satisfied (see below *The Substantial Business Activities Test*).

The consequences of failing to overcome the Stockholder Percentage Test and Substantial Business Activities Test are as follows:

- If former US Co stockholders own at least 60% but less than 80% of Foreign HoldCo, Foreign HoldCo is treated as a "surrogate foreign corporation" for US tax purposes. In this case, Foreign HoldCo is respected as a foreign corporation for US tax purposes and the transaction may be worth pursuing. However, limits are placed on the use of US tax attributes. This means that "earnings stripping" transactions on the US side of the group will be restricted.
- If former US Co stockholders own 80% or more of Foreign HoldCo, Foreign HoldCo is treated as a US corporation for US tax purposes. In this case, the transaction generally is not worth pursuing.

In an ideal inversion transaction, former US Co stockholders own less than 60% of Foreign HoldCo. However, in most cases, an inversion may still have merit and result in significant tax savings as long as US Co stockholders own less than 80% of Foreign HoldCo. In fact, in the majority of inversions to Ireland, the former US Co stockholders account for between 60% and 79% of Foreign HoldCo post-transaction.

The Substantial Business Activities Test

If a deal-related inversion fails the Stockholder Percentage Test, the US anti-inversion rules can still be overcome if the US corporate group seeks to re-domicile in a jurisdiction where it has "substantial business activities." In the past, this was an undefined concept which required consideration of all the facts and circumstances of the individual case. The lack of clarity around this test created confusion and resulted in advisors looking to the IRS for more guidance.

The IRS responded by issuing regulations in 2012 with a bright-line test. In these regulations, the IRS defined "substantial business activities" as existing in a jurisdiction where the worldwide group has at least 25% of its:

- Employees (including employee compensation).
- Assets.
- Income.

This is a difficult test for a multinational group to meet in any one jurisdiction. Since the introduction of the bright-line test in 2012, there have been very few inversions based on the worldwide group having substantial business activities in the new foreign jurisdiction. Most inversions have been structured as merger transactions with a foreign target company of appropriate size so that the former US company stockholders own less than 80% of the combined equity (see above *The Stockholder Percentage Test*).

STRUCTURING AN INVERSION

An inversion can be achieved by moving the "tax residence" of an existing holding company to a new jurisdiction (by moving its place of effective management and control outside of its existing jurisdiction for tax purposes). However, for a number of reasons this is not the most common structure for an inversion transaction. This type of inversion does not work for US companies, because the US does not have a separate concept of tax residence as distinct from the place of incorporation. In addition, in some jurisdictions, a migration of tax residence can trigger a tax charge on exit.

Therefore, it is often more effective to structure an inversion with a new parent company in the new jurisdiction and insert the new parent company between the existing parent company and the public stockholders. For public companies incorporated in a common law jurisdiction, this can often be done through a cancellation scheme of arrangement approved by the court or a share-for-share exchange. The cancellation scheme of arrangement was used by the initial self inversions to Ireland by US-listed multinationals with top holding companies in Bermuda and the Cayman Islands, and also in the case of recent inversions achieved through a merger with an Irish target company.

In a cancellation scheme of arrangement, the public stockholders agree to the cancellation or swap of their shares in the existing parent company in return for shares in the new parent company. For public companies incorporated in the EU, this can also be achieved by re-registering the existing parent company as a "Societas Europaea" (SE) (the new form of European public company) and then moving its place of registration to Ireland.

Although not available for US parent companies, EU parent companies can also migrate to Ireland by merging with an Irish public company under the "cross-border merger regulations." The cross-border mergers regulations (implementing Directive 2005/56/EC on Cross-Border Mergers) relate to European incorporated companies alone and facilitate mergers between Irish companies and those located elsewhere in the European Economic Area (EEA). European limited companies that are capable of merger under national law can merge into Irish registered companies or vice versa, with the merging company ceasing to exist on completion of the merger.

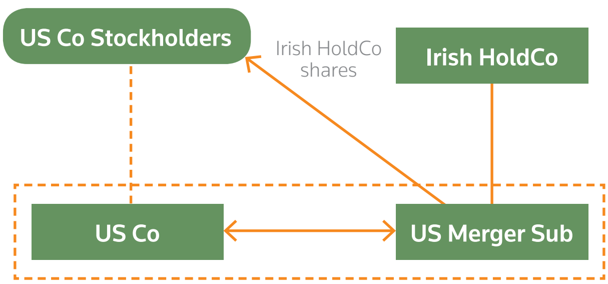
COMMON IRISH INVERSION STRUCTURE FOR US CORPORATE GROUPS

A broad outline of how many deal-related inversions of US corporate groups to Ireland are structured is set out below, although the structure will vary depending on many factors. These factors include:

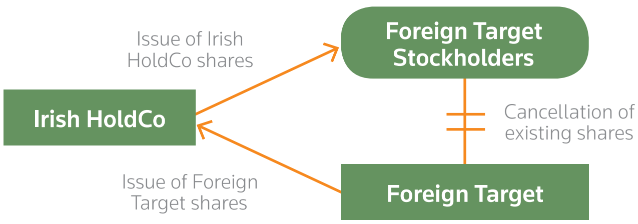
- The merger laws in the state of incorporation of the US top holding company.
- The place of incorporation of the foreign target company. The structure below assumes the foreign target is incorporated in a common law jurisdiction with cancellation scheme of arrangement provisions. However, there are alternative ways in which this can be achieved (for example, through the cross-border merger regulations or European SE, depending on the locations of the entities involved).

In this structure, a US top holding company (US Co) and foreign target company (Foreign Target) seek to combine under a new Irish holding company (Irish HoldCo). Foreign Target may or may not be an Irish company.

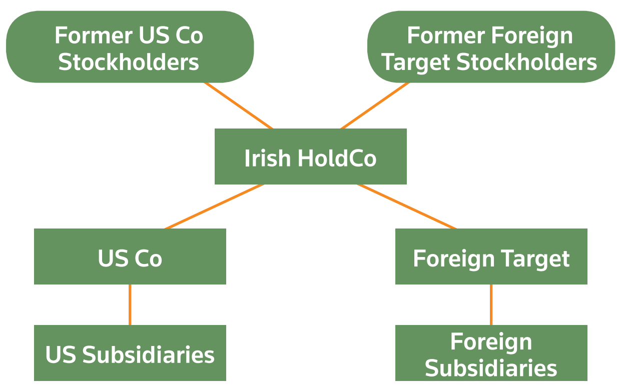
Step 1: US law merger between US Co and a newly incorporated US Merger Sub, a wholly owned subsidiary of Irish HoldCo. After this step, US Co is brought under Irish HoldCo.



Step 2: Irish HoldCo acquires Foreign Target by way of a cancellation scheme of arrangement in Foreign Target's home jurisdiction. In this step, the shares in Foreign Target held by Foreign Target's stockholders are cancelled and replaced with shares in Irish HoldCo. At the end of this step, Foreign Target is also now under the ownership of Irish HoldCo.



Following the completion of the merger and cancellation scheme of arrangement, which can be lined up to occur effectively simultaneously, the intention is that the structure will look as set out below. Ideally, where post-acquisition structuring allows, all foreign subsidiaries will be directly held under the Irish HoldCo or Foreign Target and not held under US ownership and all US subsidiaries will be held under US Co.



MAINTAINING TAX RESIDENCE IN IRELAND

After an inversion transaction, the Irish HoldCo must obtain and maintain its tax residence in Ireland. This is not simply a matter of ensuring that it is incorporated in Ireland. It is also generally necessary for the central management and control of the company to be located in Ireland and not elsewhere.

The central management and control of a company is located in the jurisdiction where the significant decisions relating to the strategic direction of the company are taken. If those decisions are taken by the directors of the company at board meetings, central management and control of a company will generally be the jurisdiction where those board meetings are held. Therefore, a US multinational group moving to Ireland must ensure that significant strategic decisions relating to the group are made at board meetings held in Ireland, in which the directors actively address the issues being evaluated and reach a considered decision.

IRISH TAKEOVER RULES, POISON PILLS AND BREAK-UP FEES

Any new Irish holding company listed on either the New York Stock Exchange or NASDAQ Stock Market is subject to the Irish Takeover Rules. The Irish Takeover Rules regulate the manner in which a takeover of an Irish holding company can be made and conducted. Experience from recent takeovers with Irish companies (for example, Cooper Industries and Warner Chilcott) has shown that, despite differing provisions at times, the Securities and Exchange Commission rules and regulations and the Irish Takeover Rules can, and do, work well together to produce successful results.

Regarding anti-takeover provisions, a number of Irish incorporated holding companies listed in the US have adopted stockholder rights plans. Although the validity of a poison pill has yet to be tested in an Irish court, they can be structured in a way so that they do not amount to a frustrating action under the Irish Takeover Rules. There are also a number of potential defenses available to Irish companies. In particular, unlike the US, potential takeover targets in Ireland benefit from provisions that may restrict a bidder's ability to acquire shares in the target company by prohibiting or delaying acquisitions, and that also have consequences related to disclosure and the terms of the bid.

In addition, under the Irish Takeover Rules, a break-up fee can only be given by the target company for specific quantifiable third-party costs if approved beforehand by the Irish Takeover Panel, and the fee cannot exceed 1% of the value of the offer.

RECENT INVERSIONS TO IRELAND

The following US corporate groups have inverted, or are in the process of inverting, to Ireland:

- Chiquita (through its acquisition of Fyffes).
- Forest Laboratories (through its acquisition of Actavis).
- Endo Health Solutions (through its acquisition of Paladin Labs).
- Perrigo Company (through its acquisition of Élan Corporation).
- Actavis (through its acquisition of Warner Chilcott).
- Eaton Corporation (through its acquisition of Cooper Industries).
- Alkermes (through the acquisition of the drug formulation and manufacturing business unit of Élan Corporation).
- Jazz Pharmaceuticals (through its acquisition of Azur Pharma).

With the exception of the Endo Health Solutions transaction, these inversions have all been effected as part of a merger with a target company incorporated in Ireland. In the Endo Health Solutions transaction, the target company was Canadian. Notably, this may be the start of a new market trend of an increasing number of inversions to Ireland where the target company is a non-Irish company.

WHY US CORPORATE GROUPS ARE INVERTING TO IRELAND

Based on the wide spectrum of established companies that have chosen Ireland as their top holding company location, including Accenture, Actavis, Alkermes, Covidien, Eaton Corporation, Ingersoll-Rand, James Hardie and Seagate, it is clear that Ireland is a popular jurisdiction for inversions. Key reasons for this popularity include:

- Its favorable tax regime and extensive tax treaty network.
- Its legal system, including its provisions relating to the preparation of financial statements under US GAAP (generally accepted accounting principles), capital management and corporate governance.
- The fact that Ireland is an "onshore" EU jurisdiction and the professional and administration services that are available locally.

IRISH TAX REGIME

Ireland is a popular country for inversions because of its favorable tax regime and extensive tax treaty network. In addition, tax rulings prior to an inversion are rarely required. Key relevant aspects of Ireland's tax regime include:

- **A low corporation tax rate.** Ireland has a low corporation tax rate (corporation tax on trading profits is 12.5%). While dividends received by an Irish incorporated company are taxed at 12.5% or 25%, a flexible credit system usually eliminates any tax liability in Ireland on receipt. In addition, other tax-free cash repatriation techniques are available.

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- **Capital gains tax exemptions.** The rate of capital gains tax in Ireland is 33%. However the sale of shares by a non-Irish resident is usually exempt from capital gains tax. An exemption also exists for disposals of 5% or more corporate shareholdings held for at least 12 months in trading companies or groups that are an EU/tax treaty resident.
- **No withholding tax for certain dividends.** Dividend withholding tax does not apply to dividends paid to persons resident in an EU or an Irish tax treaty country (for example, the US or Canada) or on US- or Canadian-listed shares held through American depositary receipts (ADRs), subject to the collection of relevant forms.
- **No stamp duty for certain transfers.** The transfer of ADRs (or shares held under an arrangement that is equivalent to an ADR structure) which are issued in respect of Irish companies and traded on a stock exchange in the US or Canada are not subject to stamp duty.
- **No withholding tax for certain interest paid.** Interest withholding tax does not apply to interest paid:
  - to persons resident in an EU or an Irish tax treaty country (for example, the US or Canada); or
  - on listed bonds or commercial paper.
- **Tax credit for research and development (R&D) activities.** A specific tax credit is available in Ireland for companies involved in R&D activities, which encompasses a broad range of activity in the R&D space.

Ireland also has signed comprehensive income tax treaties with 70 countries, including the US, all EU member states and many Middle Eastern countries. Sixty-eight of these income tax treaties are currently in effect, with the remainder to come into force shortly.

In addition, the following tax points are also relevant:

- Ireland does not have any thin capitalization rules.
- Ireland does not have any CFC rules.
- Ireland has limited transfer pricing rules.
- Ireland operates a favorable and flexible securitization and finance company regime.

IRISH LEGAL SYSTEM

One of the principal reasons why Ireland is the jurisdiction of choice for the new holding company of inverting companies is the Irish legal system and environment.

Like the US, Ireland is a common law jurisdiction and its legal concepts are recognized and understood by most investors. As a common law jurisdiction, it is less prescriptive and more flexible than civil law jurisdictions. In addition, the laws relating to personal property, the transfer of assets and the concepts of legal and equitable title are similar to those in the US. Ireland also has an experienced and efficient Commercial Court which can resolve disputes quickly and in a cost-effective manner.

The fiduciary duties of directors are similar to those under Delaware law. For example, a similar standard to the US business judgment rule applies to a review of directors' actions. Irish courts are reluctant to overturn directors' decisions, absent fraud or bad faith.

Further, like the US, Ireland has a unitary board system. A number of other European jurisdictions have dual board systems. In addition, where the new Irish holding company is only listed in the US, there is no need to separate the positions of chairman and CEO. US-style directors and officers liability insurance (D&O) policies can also be accommodated. It is also possible for a similar level of indemnity cover to be given to directors and officers by companies within the group.

Ireland specifically permits US GAAP to be used in the preparation of financial statements (both standalone and consolidated) by multinationals migrating to Ireland and which are listed in the US, instead of requiring International Financial Reporting Standards (IFRS) or Irish GAAP. The ability to use US GAAP considerably reduces the cost and administrative burden for Irish incorporated companies listed in the US and is therefore a material advantage.

In addition, Ireland provides substantial flexibility from a capital management perspective, including for:

- **Share buybacks or redemptions.** Share buybacks or redemptions can be effected without the need for stockholder approval as long as the Irish holding company has distributable profits. On completion of an inversion, an application is generally made to the Irish High Court to create distributable reserves in the Irish holding company in an amount effectively equal to the aggregate of the closing market capitalization of the merging companies. Following the creation of distributable reserves, it should be possible to maintain in place any pre-closing dividend policy. There is no need for stockholders to approve the payment of dividends.

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- **Pre-emption rights.** It is possible to disapply pre-emption rights in respect of issuances of new shares for cash for up to five years, after which the disapplication can be renewed for subsequent five-year periods by stockholder vote. There is also no pre-emptive right in the case of issuances for non-cash.
- **Blank check preferred stock.** Blank check preferred stock is permitted and is increasingly common for Irish incorporated companies. Once provided for in a company's articles of association, subject to an authority for the directors to issue shares (renewable up to every five years), blank check preferred stock can be authorized and issued by the board of directors without specific stockholder approval.

In Ireland, unlike a number of other jurisdictions, there is no binding or advisory vote and no pending legislation regarding a "say on pay" vote for director compensation. In addition, there is no need for a specific directors' remuneration report. As a matter of Irish law, Irish companies are required to include information on directors' emoluments, loans, pensions and compensation for loss of office in the annual accounts but only on an aggregated basis.

OTHER REASONS FOR CHOOSING IRELAND

In addition to its tax and legal systems, there are a number of other practical reasons to choose Ireland:

- Ireland is politically stable and a member of the Organisation for Economic Co-operation and Development (OECD) and the EU.
- Dublin, Ireland, is an established international financial center.
- Ireland has good international transport links, including numerous daily direct connections to a number of the principal business centers in the US.
- Regulatory and administrative burdens are low.
- Ireland has a young, skilled and well-educated labor force.
- Subject to meeting limited requirements, Irish incorporated, US-listed companies are eligible for inclusion in the S&P 500 index.

LOOKING AHEAD

Given the 2012 changes to the Substantial Business Activities Test in the US anti-inversion rules, it is expected that most inversions from the US will continue to take place through deal-related inversions. Specifically, it is anticipated that inversions will be structured as a merger of a US corporation with a foreign incorporated target company of appropriate size so that former US corporation stockholders own less than 80% of the foreign holding company.

Importantly, these foreign target companies do not necessarily have to be incorporated in the jurisdiction to which the merged group inverts. For example, in the recently announced inversion of Endo Health Solutions to Ireland, the target company was incorporated in Canada. Accordingly, it is likely that there will be a significant increase in the number of inversions to Ireland where the target company is a non-Irish company.

Until there is a substantial reform of the US tax code, the US tax savings that can be achieved in an inversion transaction (by moving, at a minimum, foreign profits from the US corporate tax net) can be significant. Until then, the incentive for US multinationals to look at inversions to enhance stockholder value, especially in more difficult trading times, will continue.

This article touches on some of the higher-level US issues that arise in inversions to Ireland from the perspective of Irish attorneys. The information provided should not be taken as an exhaustive list or definitive advice, and companies should seek counsel from relevant US advisors on these issues.