



IRS Releases Notice Expanding Anti-Inversion Rules and Limiting Certain Tax Benefits in Corporate Inversion Transactions

September 24, 2014

On September 22, 2014, the Treasury Department and the Internal Revenue Service announced that they intend to issue regulations under several Sections of the Internal Revenue Code of 1986, as amended (the “Code”), including Section 7874¹ (often referred to as the “anti-inversion” rule), that generally (i) expand when outbound acquisitions of a domestic company (“Domestic Target”) by a foreign company (“Foreign Acquirer”) are subject to the anti-inversion rule, and (ii) limit certain tax benefits previously available to Domestic Targets following such acquisitions. The announcement was made in response to the recent surge in such acquisitions, which the Treasury Department maintains are tax-motivated. Internal Revenue Service Notice 2014-52 (the “Notice”) contains a summary of the regulations to be issued and is described in further detail below. The Treasury Department intends that the forthcoming regulations will generally be applicable to transactions completed on or after September 22, 2014.

SECTION 7874—CERTAIN GENERAL RULES

Section 7874 only applies to those acquisitions where the Foreign Acquirer is deemed to be a “surrogate foreign corporation.” A Foreign Acquirer may be treated as a surrogate foreign corporation if (i) at least 80 percent of Foreign Acquirer stock is held by former shareholders of the Domestic Target by reason of their ownership of the Domestic Target (in which case the Foreign Acquirer would be treated as a U.S. corporation for U.S. federal income tax purposes), or (ii) at least 60 percent (but less than 80 percent) of the stock of the Foreign Acquirer is held by former shareholders of the Domestic Target (in which case a significant tax may be imposed on the transaction).

EXPANSION OF ANTI-INVERSION RULE

The Treasury Department perceived that taxpayers were structuring transactions so as to avoid having a Foreign Acquirer classified as a surrogate foreign corporation. The Notice thus describes several rules that will apply to acquisitions by a Foreign Acquirer of a Domestic Target and will make it more difficult to avoid such classification. Among other things, the Notice provides that:

- If, following such acquisition, more than 50 percent of the gross value of the Foreign Acquirer’s assets (disregarding assets held directly or indirectly by the Domestic Target) consists of certain passive assets (e.g., cash or marketable securities), a portion of the

¹ All “Section” references are to the Code.

stock of the Foreign Acquirer will be excluded for purposes of determining the percentage of stock held by former shareholders of the Domestic Target;

- If, within the three years prior to such acquisition, the Domestic Target makes non-ordinary course distributions (generally, the excess of all distributions made during a year over 110 percent of the average of such distributions during the three-year period immediately preceding such year), such distributions will be disregarded for purposes of determining the percentage of stock held by former shareholders of the Domestic Target; and
- The exclusion from the anti-inversion rule for certain intragroup restructurings involving the acquisition of a Domestic Target by a Foreign Acquirer may be limited if the Foreign Acquirer ceases to be affiliated with the group in which the restructuring occurred, including in certain transactions commonly referred to as “spinversions.”

RELATED POST-ACQUISITION TRANSACTIONS

Even if a transaction successfully avoids the application of Section 7874, the Treasury Department is concerned that inverted companies are engaging in post-acquisition transactions that improperly reduce the U.S. tax liability of the Domestic Target. The Notice therefore describes several changes to the rules that subject foreign earnings of U.S. businesses to U.S. taxation, which will limit the effectiveness of such post-acquisition transactions. In particular, taxpayers are structuring transactions between the Foreign Acquirer and “controlled foreign corporations” (“CFCs”) of Domestic Targets in a manner that may provide the Foreign Acquirer access to the CFCs’ earnings without subjecting such earnings to U.S. taxation. To address these transactions, the Notice provides that equity or debt of a Foreign Acquirer held by a CFC of the Domestic Target will generally be treated as “United States property” for purposes of Section 956 if such equity or debt is acquired as part of or within the ten-year period following the acquisition of the Domestic Target. As a result, the Domestic Target will generally be required to pay U.S. tax on the undistributed earnings of the CFC to the extent of its equity or debt investment. The Notice also describes several rules that will address certain transactions designed to avoid subjecting the earnings of a Domestic Target’s CFCs to U.S. tax by (1) transferring such CFCs “out from under” the Domestic Target to the Foreign Acquirer and (2) engaging in certain other related-party transactions that reduce such earnings for U.S. tax purposes. Finally, the Notice states that the Treasury Department and the IRS are considering guidance on the tax treatment of loans from the Foreign Acquirer to the Domestic Target, although no changes to these rules have yet been announced.

Certain of the rules described in the Notice may affect Domestic Targets and Foreign Acquirers following transactions that are not popularly considered “inversions.” In particular, these rules should be carefully examined in connection with any acquisition of a Domestic Target by a Foreign Acquirer to ensure that they do not affect the anticipated tax consequences.

CONCLUSION

The tax rules announced in the Notice are likely to affect many planned and pending transactions, and care should be taken to ensure that their consequences are properly

considered. Although the Notice states that these rules are supported by current law, certain applications of the rules may produce results that were not anticipated by Congress. Furthermore, the rules applicable to acquisitions of U.S. businesses by foreign companies will remain the subject of legislative and regulatory attention, and further changes on this subject, including potential changes to the application of existing U.S. tax treaties, are expected. While the Treasury Department has announced that such changes would apply prospectively, they are generally expected to apply to companies completing acquisitions on or after September 22, 2014.

* * *

For more information, please contact one of the following members of the Firm's Tax Department.

[John J. Creed](#)
212-455-3485
jcreed@stblaw.com

[Robert E. Holo](#)
212-455-2514
rholo@stblaw.com

[Gary B. Mandel](#)
212-455-7963
gmandel@stblaw.com

[Jonathan Goldstein](#)
212-455-2048
jgoldstein@stblaw.com

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.

UNITED STATES

New York

425 Lexington Avenue
New York, NY 10017-3954
+1-212-455-2000

Los Angeles

1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto

2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.

1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

Houston

2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

EUROPE

London

CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing

3919 China World Tower One
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong

ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul

West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo

Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo

Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000