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New SEC Interpretations and Treasury Regulations Aimed at Curbing the Inversion Epidemic Will Not Likely Have Material Effets on Future Inversion Transactions

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NEW SEC INTERPRETATIONS AND TREASURY REGULATIONS AIMED AT CURBING THE INVERSION EPIDEMIC WILL NOT LIKELY HAVE MATERIAL EFFECTS ON FUTURE INVERSION TRANSACTIONS

Over the past few years, political officials, including President Barack Obama, have deemed corporate inversions unpatriotic and thrust them into the spotlight.[1] Inversions occur when a U.S. corporation merges with or acquires a foreign corporation and reorganizes into that country, or a third-party country, if applicable. The Joint Committee on Taxation has projected that over the next ten years, the U.S. Treasury will lose $41 billion because of this tax minimization tactic.[2] While inversions are primarily tax driven, the SEC and the Treasury are attempting to curb them by implementing targeted interpretations and regulations, essentially duct-taping an issue that demands a strong overhaul of the federal corporate tax code.

The recent interpretation of Rule 14a-4(a)(3) by the SEC and the new regulations by the Treasury department will provide increased transparency in inversion transactions and reduce the number of situations where inversions are allowed, but because of the ever existent tax benefits of inversion, they likely will not have a material effect on the majority of future inversion transactions.

This article will first provide some background on corporate inversions, then lead to an analysis of the new SEC interpretation of Rule 14a-4(a)(3) and an explanation of how that interpretation does not provide any material changes to inversions. Next, the article will explain and analyze the five sets of Treasury regulations and examine why each of those sets of regulations, while narrowing the potential field of targets and making it harder for inversions to occur, is not the answer to the problem. Lastly, I will propose some solutions to the problem. Throughout this article, it is helpful to keep in mind that inversions do not occur because directors want changes in corporate governance or that they have a strong desire to merge with the foreign entity, but instead because of the extensive tax savings of inverting.

1. Mike Patton, *Will Tax Inversions Sink the U.S. Economy?*, FORBES (Aug. 12, 2014, 5:53 PM), http://www.forbes.com/sites/mikepatton/2014/08/12/will-tax-inversions-sink-the-u-s-economy/.

2. JOINT COMM. ON TAXATION, 108TH CONG., MEMORANDUM: REVENUE ESTIMATE REQUEST 3 (Comm. Print 2015), http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/JCT%20Score%20July%202015.pdf.

INTRODUCTION

Before delving into the complexities of the recent SEC interpretation and Treasury regulations, it is important to have some background on corporate inversions, including their structure, purpose, and side effects. As stated at the outset, inversions occur when a U.S. corporation merges with or acquires a foreign corporation and reorganizes into that country, or a third-party country, if applicable. In the past, inversions were regularly completed as "self-inversions," where the U.S. parent company created a foreign parent to merge with, resulting in the original U.S. shareholders owning 100% of the surviving foreign corporation.[3] These types of inversions came to a halt in 2004 when the Treasury announced its first set of inversion regulations.[4] Even after those initial regulations, inversions continued to exist because intelligent lawyers and businesspeople were able to figure out ways to invert while not running afoul of those new rules, which they continue to be able to do today even after the extra layers of regulations pile on.

Inversions are primarily entered into to shrink the corporation's tax liability.[5] At 35%, the U.S. has the highest corporate tax rate in the developed world and taxes corporations' income on a worldwide system, meaning that foreign-earned income is also taxed at the 35% rate once repatriated (subject to applicable foreign tax credits).[6] Currently, U.S. corporations have $2 trillion in unrepatriated funds held overseas because corporations are unwilling to subject themselves to the extra tax burden by repatriating them to the U.S.[7]

Even though corporations enter into these mergers with the idea of minimizing the corporation's taxes, which enhances shareholder wealth, depending on the new country of organization, there may be certain changes that could negatively affect the shareholders. In a recent transaction by Mylan, Inc., it inverted to the Netherlands by acquiring Abbot Laboratories' non-US Assets.[8] Through this transaction, the corporate

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3. DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES 2–3 (2014), https://www.fas.org/sgp/crs/misc/R43568.pdf.

4. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 801(a), § 7874, 118 Stat. 1418, 1562–66 (2004) (codified as amended at 26 U.S.C. § 7874 (2012)), http://www.gpo.gov/fdsys/pkg/PLAW-108publ357/pdf/PLAW-108publ357.pdf.

5. *Fact Sheet: Treasury Issues Inversion Regulations and Proposed Earnings Stripping Regulation,* U.S. DEP'T OF THE TREASURY (April 4, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0404.aspx

6. MARPLES & GRAVELLE, *supra* note 3, at 3.

7. Ben Marlow, *Tax Inversions: why Britain's companies are being pursued by US rivals*, THE TELEGRAPH (June 21, 2014, 6:00 PM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10916906/Tax-inversions-why-Britains-companies-are-being-pursued-by-US-rivals.html.

8. Steven Davidoff Solomon, *Mylan's Dutch Takeover Defense Is in Nasdaq's Hands*, N.Y. TIMES (June 11, 2015), http://www.nytimes.com/2015/06/12/business/dealbook/mylans-dutch-takeover-defense-is-in-nasdaqs-hands.html.

governance policies changed and Mylan was able to implement a "stitching"[9] in order to defend against a hostile takeover, a tactic which would be illegal in the U.S.[10] This transaction forced the SEC to "solve" the problem by issuing an interpretation of Rule 14a-4(a)(3). In addition, the Treasury has implemented several new regulations from 2004 to 2016, but they have been more focused on reducing the pool of potential foreign targets that U.S. corporations may acquire.

I. SEC UNBUNDLING RULE 14a-4(a)(3)

Regardless of what the board of directors claims, the principal goal of inversion is to lower the corporation's tax liability.[11] When a corporation wants to invert, the shareholders of the acquiror and the target must approve of the merger.[12] Due to the strong tax considerations, many shareholders overlook the potential negative consequences that may result from the inversion. This happens because when the shareholders vote on the merger as a whole, they focus on the hefty tax savings that is likely to increase the value of their stock.[13] Unbeknownst to the shareholders, within these votes there can be hidden items that can potentially outweigh the tax benefits. During the previously discussed Mylan inversion, this is exactly what happened, spurring the SEC to amend the voting requirements of the target corporation.

During the Mylan transaction, Mylan inverted to have its country of organization changed to the Netherlands with the shareholders approving the deal as a whole.[14] The tax savings for moving to the Netherlands was substantial and the board of directors claimed there were other reasons for the deal, such as "operational flexibility, improved cash management, and an enhanced ability to access international capital markets."[15] When it was all completed, the shareholders found out the hard way that the inversion might have not been the best decision. This is because three months after the inversion, Teva Pharmaceuticals made a tender offer for Mylan's shares, which the Mylan board of directors opposed.[16] At this point during a hostile takeover, the target may implement defensive tactics to attempt to dissuade the hostile bidder from continuing its attempt-

9. A "stitching" occurs when a Dutch company creates a trust and issues it preferred shares. This trust has its own independent board of directors that is supposed to act in the best interest of the company. If this independent board of directors sees danger to the company, it can exercise the preferred shares and take control of the company, effectively halting the hostile takeover.
This would be illegal in the United States because it violates the basic rule of directors not being allowed to make decision to entrench themselves in office.

10. Solomon, *supra* note 8.

11. MARPLES & GRAVELLE, *supra* note 3, at 3.

12. Jeffery Bell, Enrico Granata & Isaac Raskin Young, *Just in Time for Proxy Season, SEC Provides New Guidance on Shareholder Proposal "Unbundling"*, LEXOLOGY (Feb. 25, 2014), http://www.lexology.com/library/detail.aspx?g=dad24c80-d2b0-4485-bf43-0e8cd81d4544.

13. Bell, Granata & Raskin, *supra* note 12.

14. Solomon, *supra* note 8.

15. MARPLES & GRAVELLE, *supra* note 3, at 5.

16. Solomon, *supra* note 8.

ed takeover. In the United States, there are strict rules for what is allowed as a defensive tactic, but the Netherlands subjects its corporations to much looser defensive tactic standards.[17]

After the inversion, Mylan created a "stitching," which is used as one of the previously discussed defensive tactics. Mylan's board of directors had no interest in making "Teva's problems our own," even though they were offering about a 60% premium over the then trading stock price.[18] This stitching effectively shielded the company from any hostile takeover and is seen as a "just say never" defense.[19] In Mylan's case, it issued preferred shares worth up to 50% of Mylan's shares at a price of 1 euro cent per share.[20] Therefore, after the inversion, the Mylan shareholders had the benefit of the tax savings, but were prevented from getting the approximately 60% premium on their shares that Teva offered, because of this stitching.[21]

The SEC frowned on this result and believed it was unfair to the shareholders because it seemed as though the board of directors was able to hide the critical changes to corporate governance within the overall merger agreement. As a result, it issued new interpretations of the "unbundling" Rule 14a-4(a)(3). The Unbundling Rule 14a-4(a)(3) requires that proxy statements "identify clearly and impartially each separate matter intended to be acted upon" at a stockholder meeting.[22] This new interpretation does not change the past guidance with respect to the required vote by the shareholders of the acquiror because they already were required to vote on material changes; it only affects the voting requirements for the target company.[23] Therefore, in the Mylan situation, the shareholders would have had to vote on the material change to corporate governance, which may or may not have prevented them from passing the inversion. But while the shareholders of the target must vote on these separate items, their votes are non-binding. Essentially, all the new interpretation does is to ensure that the shareholders know what they are getting from the overall transaction. The new interpretation simply pro-

17. In the U.S., when there is a hostile takeover, the directors are under an enhanced duty to show the decisions are to further the welfare of the corporation and not to entrench themselves in office. Then, after good faith and reasonable investigation, the directors must believe there is a legitimate threat to corporate policy and effectiveness. The response to the threat then may not be coercive or preclusive and the response must be in a range of reasonable responses to the threat perceived. A stitching would not meet the standard of a reasonable response but would likely be seen as entrenching the directors in office.

18. Solomon, *supra* note 8.

19. Steven Davidoff Solomon, *Regulators Unbundle Some Attractions of Mergers*, N.Y. TIMES (Nov. 3, 2015), http://www.nytimes.com/2015/11/04/business/dealbook/regulators-unbundle-some-attractions-of-mergers.html.

20. *Id.*

21. *Id.*

22. *Exchange Act Rule 14a-4(a)(3)*, SEC, https://www.sec.gov/divisions/corpfin/guidance/exchange-act-rule-14a-4a3.htm (last updated: Oct. 27, 2015).

23. *Id.*

motes transparency. In addition, the overall merger may be conditioned on the shareholders approving of each material change. Therefore, it is still possible, if not likely, that the average shareholder prefers the immediate tax savings, and is not concerned with corporate governance, approving the merger regardless.

The new SEC interpretation is not likely to make much of a difference in deterring corporate inversions, which is the primary reason they were put in place. In effect, the new requirement is for the target shareholders to vote on material changes to the acquiror's organizational documents.[24] While the shareholder's vote on these material changes, their votes are non-binding to the corporation and the corporation is permitted to condition the merger on the approval of each material change.[25] In reality, the rules only increase the visibility of potential changes, but are unlikely to change the overall result of the merger because of the strong incentive for current gains from the tax savings.[26]

Ultimately, it seems that regardless of the potential future negative consequences to shareholders through a drastic change of corporate governance, such as the defensive tactic of stitching, it is likely that this rule will not slow the inversions because of the immediate tax consequences. The majority of shareholders do not understand the complexities around the corporate governance rules, nor do they care. They want more money and they want it now. This is why this new interpretation, while allowing for transparency in the transaction, will not have a material effect on future inversion transactions.

II. TREASURY REGULATIONS

While the SEC recently took a stand against allowing material changes to slide through the merger transaction without the shareholders' knowledge, for years the Treasury department has been issuing regulations to curb the tax benefits of inversion. These treasury regulations are intended to ensure that either the U.S. corporation is materially merging with a foreign corporation or that the U.S. corporation has a substantial business presence in the new country. These regulations have been getting stricter each time they are issued. As of today, five sets of regulations have been implemented: 2004, 2012, 2014, 2015, and 2016.

These rules have been slowly increasing the restrictions on corporate inversions. For each of the five sets of regulations, it seems that whatever is the "issue of the day" is addressed. Effectively, if the Treas-

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24. Abigail Pickering Bomba et al., *SEC's "Unbundling Rule" Interpretation Requires New Non-Binding Target Stockholder Vote on Acquiror's Material Governance Changes in M&A Transaction—But Unlikely to Have any Practical Impact*, FRIED FRANK: FRIED FRANK M&A BRIEFING (2015), http://www.friedfrank.com/siteFiles/Publications/FINALv3-11-16-2015-TOC%20Memo-SECs%20Unbundling%20Rule%20Interpretation%20Requires.pdf.

25. *Id.*

26. *Id.*

ury continues on its current path of issuing sets of regulations every few years, it may shut down the inversion market by eliminating viable foreign targets. This is not the best solution and would simply put the U.S. corporations at a further disadvantage in the global market.

A. 2004 American Jobs Creation Act

In the 1990s and early 2000s, corporations were inverting to countries where there were no business operations, and the original shareholders would still own 100% of the resulting corporation.[27] These were known as "naked" inversions because nothing of substance actually took place.[28] The American Jobs Creation Act of 2004 (2004 Act) effectively stopped these types of inversions from happening.[29] The 2004 Act stated that if the U.S. corporation owned 80% or more of the surviving corporation, it was disallowed for federal tax purposes and the corporation was still treated as a U.S. company.[30] It provided a different avenue for a corporation to invert as well if the corporation had 10% or more of its business operations in the new country.[31]

While the 2004 Act shut down naked inversions, it didn't shut the door on inversion. The 2004 Act paved the way for stricter regulations to come.

B. 2012 Treasury Regulations

This set of regulations was only aimed at one thing: increasing the amount of business operations in the foreign country to 25%, up from 10% in the 2004 Act.[32] The 2012 Treasury Regulations kept the post-inversion shareholder ownership to no more than 80%.[33] Therefore, under this regulation, a U.S. company could invert to a foreign country if 25% of its business operations were in that country or the surviving entity was owned by 20% or more of the foreign shareholders.[34]

While this strengthened the percentages corporation's needed in terms of business operations and shareholder ownership, it also kept the door open for companies to invert. The 2012 Treasury Regulations, like the 2004 Act and the later 2014, 2015, and 2016 regulations, simply forced the U.S. corporation to search harder for a foreign corporation that would meet these standards.

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27. MARPLES & GRAVELLE, *supra* note 3, at 7.
28. *Id.*
29. *Id.*
30. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 801(a), § 7874, 118 Stat. 1418, 1562–66 (2004) (codified as amended at 26 U.S.C. § 7874 (2012)), http://www.gpo.gov/fdsys/pkg/PLAW-108publ357/pdf/PLAW-108publ357.pdf.
31. *Id.*
32. MARPLES & GRAVELLE, *supra* note 3, at 7.
33. *Id.* at 10.
34. MARPLES & GRAVELLE, *supra* note 3, at 7.

C. 2014 Treasury Regulations (Notice 2014-52)

On September 22, 2014, the Treasury and IRS released Notice 2014-52 (Notice) in order to make it more difficult for U.S. companies to invert and to reduce the tax benefits of corporate inversions.[35] The new rules promulgated in this Notice only apply to deals closed on or after September 22, 2014.[36] The primary change contained in the Notice is that if the foreign acquiror's stock is more than 50% passive assets,[37] a portion of the foreign acquiror's stock will not be counted when calculating the 80% test.[38] In addition, extraordinary dividends[39] paid by the U.S. company to reduce its size before the inversion will not be regarded.[40] Prior to this, it was too easy for corporations to manipulate the 80% test by stuffing the foreign corporation with passive assets and making large dividends pre-inversion to the U.S. shareholders in order to shrink the size of the U.S. corporation.

The Notice will also affect already inverted companies by preventing inverted companies from accessing deferred foreign income through its controlled foreign corporation by way of "hopscotch" loans to the U.S. parent.[41]

This set of regulations is yet another example of the Treasury trying to make it harder on companies to find foreign corporations to invert into. The Treasury is simply finding a loophole and trying to close it, and by the end the SEC is going to have ten different pieces of duct tape holding together a shattered vase.

D. 2015 Treasury Regulations

On November 19, 2015, the U.S. Treasury announced new regulations in an attempt to once again provide a targeted approach to a large problem. It announced a major setback to using third party countries in an inversion transaction which could potentially halt many deals. What this is targeting is when a U.S. company merges with a target, but then reorganizes the surviving corporation in a third country.[42] For example, in the Endo Health transaction, the U.S. company, Endo Health, bought a Canadian company, Paladin Labs, and relocated the combined organiza-

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35. I.R.S. Notice 2014-52, 2014-42 I.R.B. 712.

36. *Id.*

37. Passive assets are assets of a business that are not needed at that point in time in order for the business to operate.

38. I.R.S. Notice 2014-52, *supra* note 23.

39. Extraordinary dividends are irregular dividends that are not derived from profits arising out of the ordinary course of business.

40. I.R.S. Notice 2014-52, *supra* note 23.

41. *Id.*

42. I.R.S. Notice 2015-79, 2015-49 I.R.B. 775; *see also Fact Sheet: Additional Treasury Actions to Rein in Corporate Tax Inversions*, U.S. DEP'T OF THE TREASURY (Nov. 19, 2015), https://www.treasury.gov/press-center/press-releases/Pages/jl0281.aspx. x

tion to Ireland.[43] These regulations will largely halt these types of transactions. If a company wants to pursue the inversion transaction, it must locate a company in the country of relocation.

The current law allows inversions as long as the resulting corporation has 25% or more of its business activity in the foreign country or the U.S. parent owns less than 60% of the resulting corporation. If the U.S. corporation owns 80% or more of the resulting company, the inversion will not be recognized for federal tax purposes, unless the business activity is met. This regulation impacts the transactions where the U.S. parent owns between 60% and 80% of the resulting corporation.

Specifically, this regulation is intended to limit the ability of U.S. companies to combine with foreign entities when the new foreign parent is located in a third country. Specifically, it will disregard the stock of the foreign parent when determining the 80% rule, making it much more difficult to reach the required stock ownership levels.

Prior to these regulations, U.S. corporations could merge with a corporation of a third party country and reorganize in any country it chose, as long as it met one of the two tests. This restricts the substantial business activities exception by adding that the 25% test is only allowed to apply within the country of origin of the foreign company.[44] This prohibits cherry picking any foreign corporation and reorganizing in the country to meet the 25% test.

Prior regulations have included an anti-stuffing mechanism that prohibits the foreign corporation's stock attributable to stuffed assets from being included in determining the 80% test.[45] Prior to that, corporations could stuff the foreign company with assets pre-merger and make it seem larger that it truly was. This regulation clarifies that this rule applies to any assets acquired with the principal purpose of avoiding the 80% rule, regardless of whether or not the assets are passive.[46]

Lastly, the 2014 regulations aimed to prevent the U.S. company from making extraordinary dividends in anticipation of the merger.

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43. Ailish Finnerty & Christopher McLaughlin, *Inversions to Ireland*, WESTLAW: PRACTICAL LAW (Mar. 25 2014), https://a.next.westlaw.com/Document/I9b42c109b45111e398db8b09b4f043e0/View/FullText.html?navigation-Path=Search%2Fv3%2Fsearch%2Fresults%2Fnavigation%2Fi0ad705260000015139e4ddd3413adfe0%3FNav%3DKNOWHOW%26fragmentIdentifier%3DI9b42c109b45111e398db8b09b4f043e0%26startIndex%3D1%26contextData%3D%2528sc.Search%2529%26transitionType%3DSearchItem&listSource=Search&listPageSource=aa9fbb1561643decd6e22bf93f95ad59&list=KNOWHOW&rank=1&grading=na&sessionScopeId=860f5e0caa5b1699823cbe24ed8c8d9e&originationContext=Search%20Result&transitionType=SearchItem&contextData=%28sc.Search%29.

44. I.R.S. Notice 2015-79, 2015-49 I.R.B. 775; *see also Fact Sheet: Additional Treasury Actions to Rein in Corporate Tax Inversions*, U.S. DEP'T OF THE TREASURY (Nov. 19, 2015), https://www.treasury.gov/press-center/press-releases/Pages/jl0281.aspx. x

45. *Id.*

46. *Id.*

These new regulations restrict that rule by not applying it when a foreign corporation acquires a U.S. company in an all-cash or mostly cash acquisition.

The body of the Press Center Fact Sheet for the November 19, 2015 regulations even contains the idea that only legislation can decisively stop inversions, and this is coming from the Treasury department.[47] The Treasury knows that the regulations that it puts forth only target specific issues and attempt to make it more difficult for U.S. corporations to meet the standards in order to invert. All this regulation does is provides limited situations where inversions will be allowed, so they are effectively curbed. It further states that it has been working with Congress for years to reform the business tax system in order to make it simpler and more pro-growth, providing incentives to encourage companies to remain in the U.S.

E. 2016 Treasury Regulations

In a much quicker turnaround that the past regulations, the Treasury department sent out additional regulations on April 4, 2016 in attempt to further curb inversion transactions.[48] At first glance, the new regulations seem to provide a closer “end-all” to inversions, but in fact seem to be targeted at one individual transaction, the Pfizer – Allergan merger.

These particular regulations, while temporary, are a combination of reducing the potential foreign suitors for American corporations as well as reducing the benefits of earnings stripping.[49]

The regulations curbing the potential suitors prevents foreign corporations that have engaged in mergers with American companies in the last three years from using those acquired companies’ value in computing its current value.[50] This affects whether or not the American company will have a small enough stake in the resulting corporation to allow the merger. For example, in the Allergan – Pfizer merger, Allergan had only been worth $20 billion or less three years ago, while Pfizer was worth about $150 billion.[51] Had these two companies merged at that time, Pfizer’s shareholders would have held more than 80% of the combined company, running afoul of the current laws. Between then and now, Allergan merged several times and now has a market capitalization

47. *Id.*

48. *Fact Sheet*, *supra* note 5.

49. Earnings stripping allows the U.S. company to deduct more tax than they actually earn in the foreign market. This incentivizes the foreign parented firms to load up their U.S. subsidiaries with related-party debt. This minimizes U.S. taxes by paying deductible interest to their new foreign parent or one of its foreign affiliates in a low-tax country. The new regulations will prevent this by treating these related-party debt as stock as opposed to treating it as debt, as has been past practice.

50. *Fact Sheet*, *supra* note 5.

51. Michael J. de law Merced & Leslie Picker, *Pfizer and Allergan are Said to End Merger as Tax Rules Tighten*, N.Y. TIMES (April 5, 2016), http://www.nytimes.com/2016/04/06/business/dealbook/tax-inversion-obama-treasury.html

of about $100 billion. Currently, the Pfizer shareholders would only own about 60% of the combined company, permitting the merger. This has lead the Pfizer CEO to proclaim that "it really looked like they did a very fine job of constructing a rule here—a temporary rule—to stop this deal, and obviously it was successful."[52] Considering the hastiness of the regulations and the fact that they are temporary, it is likely he is correct in his assumption, regardless of what the Treasury states.[53]

While the Pfizer-Allergan merger has been halted based on these new regulations, none of the other six large inversion deals that were going on at the time of the announcement should be affected.[54] Therefore, while at first glance it may seem that if these regulations affected the largest inversion in history it must affect the smaller ones, it seems as though it will not.

F. Effect of the Regulations

Each of these five sets of regulations have been aimed at fixing an immediate problem. Whatever seems to be plaguing the inversion market at that given point in time is what each regulation addresses. In addition, they are slowly making inversions more restrictive, which if continued, may effectively shut down the inversion issue all together, but tighter regulations are not the answer. The stronger these regulations become, the more of a disadvantage the U.S. corporations will have against the worldwide market. These new treasury regulations simply provide more assurance that inversion transactions will be curbed, but are still a targeted approach for a problem that should be fixed with a complete tax overhaul.

The Treasury is simply finding a loophole and trying to close it, and in the end that duct-taped vase is going to shatter again.

III. TAX CODE REFORMATION

While the several rules and regulations enacted by the Treasury and the SEC have curbed inversion deals in the past year, they are not long term inversion prevention solutions. The only long-term and correct way to fix the current inversion problem is corporate tax reform. The U.S. taxes it corporations at 35%, higher than any other developed country.[55] In addition, the U.S. taxes its corporations on a worldwide system, meaning that foreign earned income is taxed by the U.S., whereas most other

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52. Tom DiChristopher & David Faber, *Allergan CEO: Merger with Pfizer was Targeted by US Government*, CNBC (April 6, 2016), http://www.cnbc.com/2016/04/05/pfizer-allergan-will-mutually-terminate-merger-over-inversion-rule-changes-sources-say.html.

53. *Id.*

54. Merced & Pickler, *supra* note 51.

55. MARPLES & GRAVELLE, *supra* note 3, at 2, 12.

countries use the territorial system, allowing foreign earned income to avoid tax once repatriated.[56]

Tax code reformation could take many forms, and is likely not to take place for several years. Ideally, the reform would allow U.S. companies to compete on an equal level with foreign companies that pay substantially less taxes.[57] This could occur through a reduction of the current 35% rate, moving to a territorial tax system, or both.

CONCLUSION

At the bottom line, the only way to "fix" the inversion "problem" is for Congress to completely overhaul the corporate tax code. It's obvious at this point that Congress is very reluctant to pursue this policy change, if not at least until after the upcoming presidential election. Therefore, in the meantime the Treasury department and the SEC seem to have been tasked with the responsibility of curbing inversions until the real policy makers can get around to it.

The issue here is that the Treasury and the SEC aren't going to completely fix the inversion issue through policy interpretations of corporate governance rules and Treasury regulations, when the entire issue resides in the realm of tax overhaul. The vast majority of shareholders have no idea what corporate governance rules are. They are in the stock market to make money, and when they hear tax savings, dollar signs roll over their eyes. These shareholders couldn't care less at the outset if the corporation may implement a stitching trust. That, along with their votes not being binding, leads to the simple conclusion that the SEC interpretation in response to the Mylan transaction is just a sham. It won't materially affect any future transactions.

While the SEC interpretation has no chance at curbing inversions, the Treasury regulations do by simply reducing the field of potential suitors. The issue with these regulations is more along the lines of curbing the transactions in the wrong way. They are just making it harder to find a suitor in a foreign country. If you limit the field of viable foreign corporations, at some point you will effectively curb the trend. But that's not fixing the problem. Currently, because of how high the United States' corporate tax rate is, an American company could likely find a foreign suitor, however hard to perform the merger, that would benefit the company's bottom line. Ultimately, the corporation will determine how important it is to save 20–25% on its foreign earned income. Likely, the board of directors will place a high emphasis on saving that money. So while the SEC and Treasury department will likely continue to im-

56. *Id.*
57. John D. Mckinnon & Scott Thurm, *U.S. Firms Move Abroad to Cut Taxes*, WALL ST. J. (Aug. 28, 2012 9:38 PM), http://www.wsj.com/articles/SB10000872396390444230504577615232602107536.

plement policy change, until Congress changes the tax code, these changes are not likely to materially affect future inversion transactions.

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