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Burger King-Tim Hortons deal

10 things to know about corporate inversions

The Associated Press

Burger King is drawing a lot of flak over plans to shift its legal address to a foreign country by merging with Tim Hortons, the Canadian coffee-and-doughnut chain.

The transaction is called a corporate inversion, a maneuver that is becoming popular among companies looking to lower their tax bills.

Burger King executives insist they are not trying to escape U.S. taxes. But some members of Congress aren't buying it, mainly because the corporate headquarters of the new parent company will be in Canada.

"With every new corporate inversion, the tax burden increases on the rest of us to pay what these corporations don't," said Sen. Dick Durbin of Illinois, the No. 2 Democrat in the Senate. "I'm disappointed in Burger King's decision to renounce their American citizenship."

Ten things to know about corporate inversions:

What is a corporate inversion?

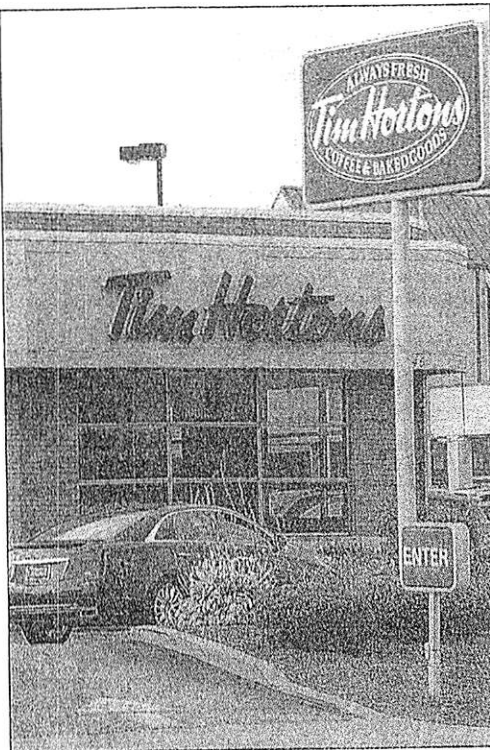
An inversion happens when a U.S. corporation and a foreign company merge, with the new parent company based in the foreign country.

For tax purposes, the U.S. company becomes foreign-owned, even if all the executives and operations stay in the U.S.

Why invert?

There can be many business reasons for two companies to merge.

The decision to incor-



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Burger King struck an \$11 billion deal to buy Tim Hortons that could make the Canadian coffee-and-doughnut chain more of a household name around the world.

money overseas, either to invest abroad or to shield it from U.S. taxes.

Experts say the total amount could exceed \$2 trillion.

If a foreign subsidiary sends profits directly to a U.S. corporation, the U.S. firm must pay taxes on it.

However, if those profits are funneled through a foreign parent company that was formed through an inversion, the money can be invested in the U.S. without paying U.S. taxes.

The technique is called "hopscotching" because the money — at least on paper — bounces from

But in the current political climate, it's hard to see House Republicans, Senate Democrats and the Obama White House all agreeing on a fix. We're talking about taxes, and Republicans and Democrats don't agree on much when it comes to taxes.

Can Obama act alone?

The Treasury Department says it is "reviewing a broad range of authorities for possible administrative actions that could limit the ability of companies to engage in inversions, as well as approaches that could meaningfully

tions stay in the U.S.

Why Invert?

There can be many business reasons for two companies to merge.

The decision to incorporate the new parent company in a foreign country can generate significant tax savings over time.

The U.S. has the highest corporate income-tax rate in the industrialized world, at 35 percent.

The U.S. also is the only developed country that taxes corporate profits earned abroad. Foreign profits are subject to U.S. taxes once they are brought to the U.S., though corporations can deduct any foreign taxes paid.

Companies that become foreign-owned do not have to worry about the IRS trying to tax the profits they make abroad.

Most U.S. corporations pay federal income taxes at rates much lower than 35 percent because the tax code is filled with breaks for businesses.

Inversions open the door for even more.

'Earnings stripping'

Inverted corporations must still pay U.S. taxes on the profits they earn in the U.S. However, they can lower their U.S. tax bills through a maneuver called "earnings stripping."

Here's how it works: The new foreign parent company "lends" money to the U.S. firm, which must pay it back. The U.S. firm then deducts the interest payments it makes to the parent company, reducing its taxable profits — "stripping" them from its balance sheet.

"You haven't raised any new money," said Robert Willen, a New York-based tax adviser. "All you've done is literally out of thin air, you've created a debt obligation on which the U.S. company is the debtor and the foreign parent is the creditor."

'Hopscotching'

Many U.S.-based corporations are hoarding

that was formed through an inversion, the money can be invested in the U.S. without paying U.S. taxes.

The technique is called "hopscotching" because the money — at least on paper — bounces from country to country while avoiding U.S. taxes.

How big is the issue?

Nearly 50 U.S. companies have inverted in the past decade, and more are considering it, according to the nonpartisan Congressional Research Service.

The recent wave of inversions has been dominated by health care companies, including drugmaker AbbVie, which has announced plans to merge with a drug company incorporated in Britain.

Walgreen Co. had been considering an inversion, but the nation's largest drugstore company announced in early August that it will no longer pursue one.

What has Congress done?

In 2004, Congress tried to curb inversions by saying U.S. companies could not escape U.S. taxes by simply reincorporating abroad, with the same shareholders and executives running the new company.

Instead, Congress passed a law saying that in order to become a foreign-owned corporation, U.S. companies must merge with a foreign partner, even if the foreign partner is much smaller.

Will Congress do more?

Several Democrats in Congress have announced bills to make it harder for U.S. corporations to invert. Sen. Ron Wyden, D-Ore., chairman of the Senate Finance Committee, said he was working with key Senate Republicans in an effort to come up with a bipartisan response.

President Barack Obama included provisions in his 2015 budget request to limit inversions. The president has renewed his push in recent weeks.

The Treasury Department says it is "reviewing a broad range of authorities for possible administrative actions that could limit the ability of companies to engage in inversions, as well as approaches that could meaningfully reduce the tax benefits after inversions take place."

Experts are divided over how much Treasury can do without action by Congress.

What do Democrats say?

Obama and Democratic leaders in Congress have questioned the patriotism of corporate executives who elect to invert their companies. At the same time, they are trying to make it a political issue ahead of this year's congressional elections, accusing Republicans of protecting corporate loopholes.

"They are renouncing their citizenship even though they're keeping most of their business here," Obama said in a recent speech. "They shouldn't turn their back on the country that made their success possible."

What do Republicans say?

Key Republicans say the only way to adequately address inversions is to overhaul the tax code, making it more attractive for businesses to locate in the U.S.

"Anything short of that and you're not going to be able to do it," said Sen. Orrin Hatch of Utah, the top Republican on the Senate Finance Committee.

Hatch and other Republicans say they could support limited efforts to fight earnings stripping, which many see as nothing more than a tax dodge.

But in general, Republicans said they do not like the idea of punishing corporations for trying to lower their tax bills.

"We want to promote American competitiveness, not hurt it," said Rep. Charles Boustany of Louisiana, a senior Republican on the House Ways and Means Committee.