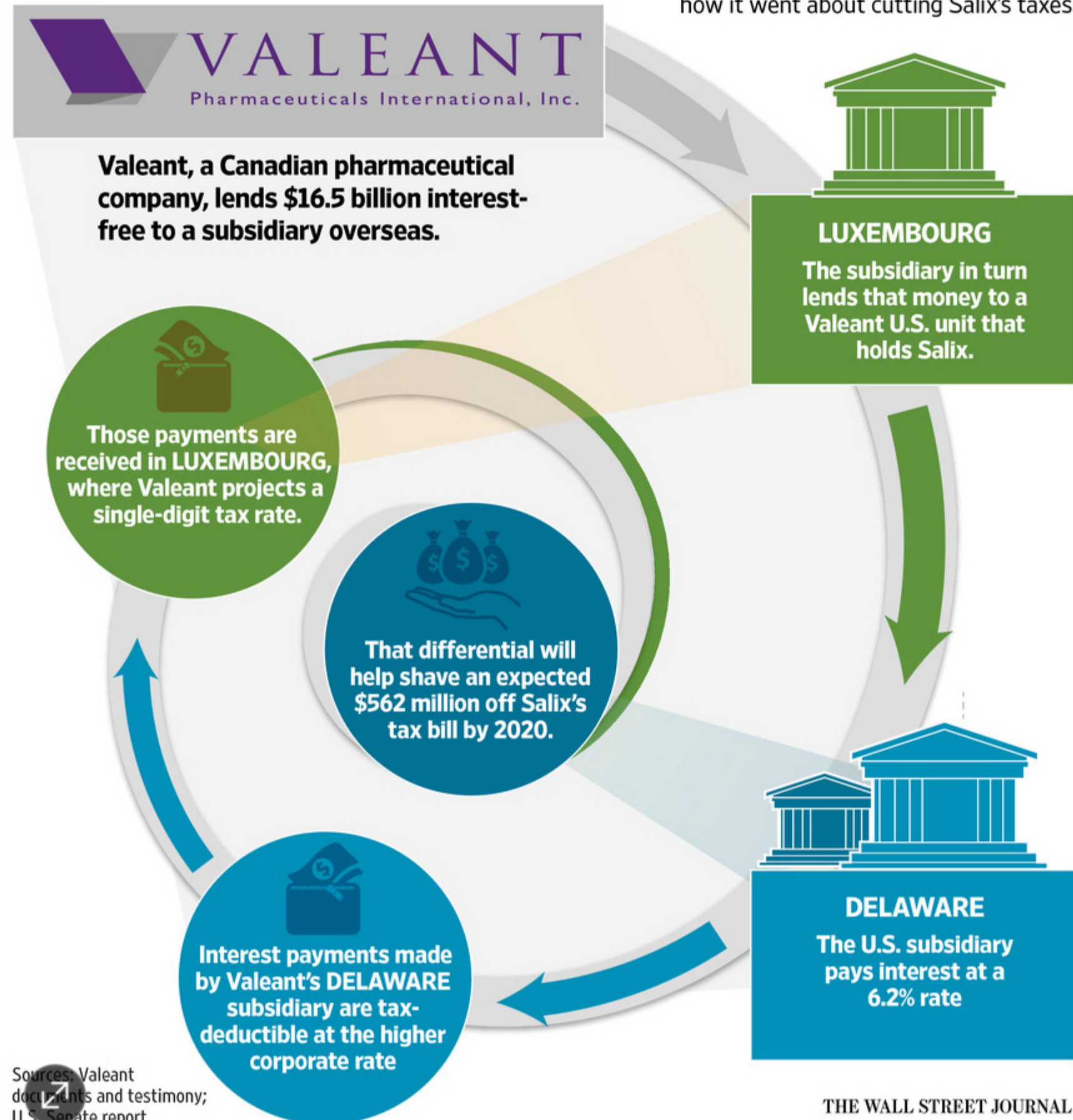


Curbs Don't Stop Tax-Driven Mergers

'Inversion' deals, foreign takeovers continue apace

Tax Spiral

In April, Valeant bought U.S.-based Salix Pharmaceuticals for \$11 billion. Here's how it went about cutting Salix's taxes.



By LIZ HOFFMAN and JOHN D. MCKINNON
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29 COMMENTS

When Salix Pharmaceuticals Ltd. last October abandoned plans to buy an Irish drug company and move its headquarters overseas, it was chalked up as a win for Washington over "inversion" deals that were structured to avoid U.S. taxes.

The victory was short-lived. In the year since the Treasury Department tightened its rules to reduce the tax benefits of such deals, six U.S. companies have struck inversions, compared with the nine that did so the year before.

Meanwhile, foreign takeovers of U.S. companies have soared, with similarly draining effects on U.S. coffers. Just six months after calling off its inversion, Salix itself was sold to a Canadian rival, which expects to shave more than \$560 million off Salix's tax bill over the next five years, new documents show.

The results highlight the challenge for Washington in holding onto corporate tax dollars amid a global mergers-and-acquisitions boom. U.S. businesses, which are subject to a 35% tax rate, are worth more in the hands of more lightly taxed foreign rivals. The savings let overseas buyers offer high prices for those assets, which ramps up pressure on American boards to sell.

Sen. Rob Portman (R., Ohio) called the Treasury's regulations "a Band-Aid." He added: "The U.S. tax code is noncompetitive. Until we fix that, we'll continue to see American companies leave, one way or another."

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U.S. companies have long used creative accounting and legal maneuvers to lower their taxes, but inversions struck many critics as extreme and hit a political nerve. A string of proposed inversions by big, prominent U.S. companies like Pfizer Inc. and Burger King catapulted the issue to the fore.



A production line at Coca-Cola Enterprises' bottling plant in the U.K. PHOTO: CHRIS RATCLIFFE/BLOOMBERG

The practice typically involved an American company acquiring a smaller foreign firm and then reincorporating abroad. That way, it could take advantage of lower overseas tax rates while still maintaining control of its operations.

The Treasury stepped in a year ago. New regulations—the agency's third broad attempt since 2004 to curb inversions—limit the ability of inverted companies to access their overseas cash, which makes these deals harder to strike and more expensive to finance.

While the move thwarted some pending inversions and temporarily chilled new announcements, it hasn't eliminated them. Bottler Coca-Cola Enterprises Inc. and fertilizer maker CF Industries Holdings Inc. announced deals in August that would move them to the U.K. Crane maker Terex Corp. and medical-device company Wright Medical Group Inc. are planning to move to Europe through inversions.

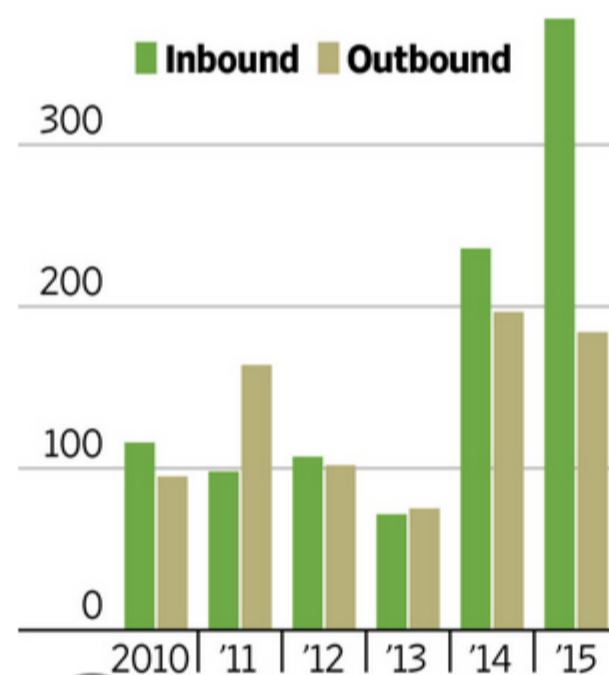
Meanwhile, the pressures that drove inversions remain, and they make U.S. companies attractive takeover targets for foreigners, executives and advisers say. Overseas buyers of American companies can reap the same tax savings that inversions produce.

Foreign Flight

More foreign firms are buying U.S. rivals than the reverse.

M&A deals, year to date

\$400 billion



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Mr. Portman and Rep. Paul Ryan (R., Wis.), the former vice-presidential candidate, are trying to line up support in Congress for a tax overhaul that they say could reduce the incentives for companies to move overseas. But many doubt a bill can get passed before the 2016 election cycle hits full speed, and few agree on what an overhaul should look like.

Some big American companies are becoming more vocal in calling for tax-code changes. Brown-Forman Corp., the maker of Jack Daniel's whiskey and the only major publicly traded U.S. spirits company following a parade of takeovers by foreigners, has been lobbying members of Congress.

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- [U.S. Issues New Rules to Combat Tax Inversions](#) (Sept. 22, 2014)
- [Race to Cut Taxes Fuels Urge to Merge](#) (July 14, 2014)

The company, whose roughly 31% tax rate is far higher than those of rivals such as U.K.-based Diageo PLC, says it has largely been priced out of the market for takeovers, which are a major engine of growth. Instead it has resorted to expanding by building brands from the ground up, such as a revival of defunct Irish whiskey label Slane.

"Senators and congressmen acknowledge we are at a distinct competitive disadvantage," said Jane Adam, Brown-Forman's senior vice

president for tax. "But it's just hard for them to come to agreement on what the solution is."

Under foreign ownership, American companies can shield much of their income from U.S. taxation through a variety of legal means. One involves piling debt onto U.S. assets and deducting the interest payments. Companies also can move income-generating patents overseas. They also can make free use of profits generated overseas without paying the full U.S. rate, which is levied on American companies' profits wherever they are earned.

Canada's Valeant Pharmaceuticals International Inc., which itself left the U.S. through a 2010 merger, plans to make use of both strategies in cutting Salix's taxes, according to documents made public by a Senate committee. The savings are expected to total \$562 million by 2020, the documents show.



Valeant Pharmaceuticals' headquarters in Canada PHOTO: CHRISTINNE MUSCHI/REUTERS

They come largely from a \$16.5 billion loan a Luxembourg-based subsidiary to Salix's U.S.-based holding company, which can deduct the interest from its U.S. income.

Valeant has used its roughly 4% tax rate as an advantage in deal making.

"There is no question that we would not be in the same place we are in today if we had a higher tax rate," Valeant's former finance chief, Howard Schiller, testified at a July congressional hearing.

One company that landed in its sights in 2014 was Allergan Inc. The California-based maker of Botox antiwrinkle treatments had posted its best year ever in 2013, with \$1.7 billion in pretax profit. Its 26.5% tax rate was low by U.S. standards.

Yet after battling a hostile bid from Valeant, Allergan sold itself to Ireland-based Actavis PLC, which paid a 4.8% tax rate last year after a 2013 inversion.

"We were a strong, profitable company, but it didn't matter," David Pyott, Allergan's former CEO, said in an interview. "The math simply did not work."

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