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Inversion reversion puts overseas shopping back in the frame

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News that the US Treasury Department will examine rolling back rules restricting American companies' ability to re-domicile overseas should have deal bankers taking a new look at their pitches for acquisition of targets like Allergan, Shire, Alexion and Jazz Pharmaceuticals.

The Obama administration tightened rules on corporate inversions – not coincidentally killing two pharma megamergers – and these will be among the regulations under review thanks to an executive order signed on Friday by President Donald Trump before tax reform legislation. The promise of a corporate rate cut could avert the need for US companies to seek low-tax foreign homes, but enactment of a massive package is by no means guaranteed, and groups desperate to lower their burden might want to take advantage of any softening towards inversions.

Reversal

The executive order calls on Treasury Secretary Steven Mnuchin to review all tax regulations issued since the beginning of 2016 to determine their complexity and burden, and whether they overstep Internal Revenue Service authority. Mr Mnuchin took the discussion one step further when he confirmed that inversion regulations would be evaluated.

It was the threat of pharma sector inversions that prompted two recent shifts in US tax policy, undermining first Abbvie's takeout of Shire and then Pfizer's bid for Allergan (*US plays break-up artist as panic envelops Pfallergan, April 5, 2016*).

Both deals fell apart because the IRS tightened rules over how companies calculate pre-merger valuations for purposes of meeting a minimum post-acquisition ownership threshold to qualify for re-domiciling to lower-tax overseas jurisdictions. In essence, the IRS does not want big US companies to buy tiny overseas ones to invert; the rules require shareholders of acquired companies to own at least 20% of the post-acquisition groups, and to enjoy full tax benefits, 40%.

For Shire-Abbvie, the IRS disregarded certain assets and transactions that were used to inflate Shire's pre-offer valuation or reduce Abbvie's to meet that 80-20 threshold. Pfizer-Allergan foundered when a three-year valuation lookback was imposed that disregarded all of Allergan's transactions since it established its Irish domicile with the 2013 Warner Chilcott acquisition.

Ireland is a sought-after tax domicile because of its 12.5% corporate rate, which is second lowest among the Organisation for Economic Co-Operation and Development countries after Hungary. Yet the UK's 19% rate was seen as attractive to Pfizer in its abortive 2014 play on Astrazeneca, given Pfizer's effective tax rate of 25% that year.

Mr Mnuchin's review appears only to take into account the rules that led to the termination of Pfizer-Allergan. Yet as a sentinel event it ought to have business development divisions and investment bankers re-evaluating strategy. Talk of a takeover of Alexion, which has Irish domicile thanks to global supply chain centralisation in Athlone, escalated on Monday, although Sanofi, a French company, is seen as a leading interested candidate.

Another look

Alexion's valuation has shrunk by more than 40% since its mid-2015 record high in the midst of allegations over improper sales practices, and in this could make the group a more attractive target. However, it would still require a significant premium over its current $26bn market cap to get to the 40% threshold for the likes of Pfizer or Abbvie – assuming they are interested.

The same is true of Jazz, which at a $9bn valuation makes it a less attractive or viable inversion target for large acquirers.

The three big acquisition-for-tax benefit targets of the past three years are currently valued below their offer prices, and it is not a stretch to see them come into play again under a newly deregulated inversion scheme.

Inversion targets, then and now		
Company	**Takeout offer**	**Current valuation**
Astrazeneca (Pfizer 2014)	$117.0bn	$75.3bn
Shire (Abbvie 2015)	$54.7bn	$52.0bn
Allergan (Pfizer 2016)	$160.0bn	$79.3bn

That is, of course, unless companies playing the tax and acquisition game are betting on a major overhaul. Lowering America's 35% corporate rate would reduce motivation to invert overseas, while a possible cash repatriation holiday would give US companies extra firepower to acquire domestic rivals.

The Trump administration's record, although short, has not been one of great success in legislative accomplishments. While Mr Trump promised that a tax reform proposal would be rolled out on April 26 – with a reported corporate tax cut to 15% – healthcare, budget and spending matters are likely to consume Congress in the coming weeks and months, potentially pushing tax reform out to 2018.

With this in mind it might be wise for business development specialists and deal bankers to reopen spreadsheets and input new assumptions. Inversion could be their bird in the hand.

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