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Ireland tax shelter beckons for Salix

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Salix Pharmaceuticals has joined the US tax inversion exodus. The North Carolina-based group is to merge with Cosmo Pharmaceuticals' Irish subsidiary in a move that will drop its income tax rate by about 15 points, but it plans no additional investment in the Emerald Isle.

The deal will allow Salix to take full ownership of the ulcerative colitis drug Uceris and brings on board two other gastrointestinal candidates. As for changing geographies, however, the group plans no radical moves, demonstrating how US companies can buy their way out of a higher tax burden while offering little in return to their new Irish hosts.

"We will have an office. In fact we already have an office there staffed with just a few people. We will continue to have that presence there, and of course we will be doing board meetings across the pond," Salix's chief executive, Carolyn Logan, said. "As far as building manufacturing plants or infrastructure in Europe to support a sales and marketing organisation, that is not our intent."

Tax advantage comes slowly

The deal will see Salix issue around 20 million shares to Cosmo to create the new Ireland-domiciled company, valuing the transaction at about $2.6bn and leaving the Italian seller with a slightly more than 20% stake. In return Salix gets the favourable tax home, which will allow it to drop its rate from "the high 30s to the low 20s", executives said in a conference call yesterday.

Salix reported a 32.6% effective tax rate in calendar 2013 as a US-domiciled entity, but as Ireland has the lowest tax rate among the industrialised nations at 12.5% the opportunity to chop its tax bill to below 20% is clear (*Vantage point – Pfizer bid ignites tax debate but fixes are distant, May 8, 2014*).

However, this will only come with time. Its finance chief, Adam Derbyshire, said Salix would not be able to move the intellectual property for established products into the favourable tax regime. That would include Xifaxan 550, its marketed hepatic encephalopathy drug forecast to achieve blockbuster sales by 2020 with the partial help of a label expansion to irritable bowel syndrome (*Salix's persistence pays off with IBS confirmation, July 2, 2014*).

On the other hand, the Cosmo pipeline products rifamycin MMX and methylene blue MMX, which were part of the transaction, should fall outside US taxation if they pass clinical muster and get regulatory approval. Future business development and M&A would be protected under the Irish umbrella, Mr Derbyshire said.

Disappointent for now

Nevertheless, the deal will be dilutive in 2015 as the corporation's "new structure" is created, a forecast that resulted in investor disappointment. Salix shares fell 5% to $130.43 in early trading this morning. The group's forecast was for single-digit dilution in 2015, although UBS analyst Marc Goodman forecasts this to be 12%.

Mr Derbyshire described the deal as "modestly accretive" in 2016 – an estimate that does not assume Xifaxan approval in IBS – and increasingly beneficial thereafter. Leerink analyst Jason Gerberry wrote, however, that his forecasts did not make the deal accretive until 2018.

The transaction contains an additional long-term benefit in full ownership of Uceris, the Cosmo-originated drug that fell under Salix's control with the acquisition of Santarus last year. This avoids an estimated $25m a year in royalties, Mr Gerberry wrote.

While this acquisition may be a disappointment in the short term, Salix is hoping that in the long term it will turn into a winner. The ability to capitalise on Ireland's tax structure has the potential to turn deals that look like money losers at the 35% statutory US rate into profitable transactions at 12.5%. Indeed, such moves can turn the acquiring companies themselves into attractive takeover targets.

Further driving this trend are the inflated prices now being demanded by targets, be they drug candidates or entire companies, making it difficult for those on the business development hunt – the next-best thing to satisfy shareholders is to cut costs, and tax inversions are one way of accomplishing this.

The danger for corporations if this trend continues is that US authorities will decide at long last to clamp down on such tax-avoidance manoeuvres, even retroactively. With two recent potential big pharma deals having hinged on tax savings, and a virtual St Patrick's Day parade of smaller transactions guided by taxes, the policy stimulus is there. Salix has only added fuel to that fire.

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