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Reprinted from *Tax Notes Int’l*, August 7, 2006, p. 515

Special Reports



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The authors wish to express their gratitude to Ameet Ashok Ponda, Jonathan B. Dubitzky, and Amy E. Sheridan for their thoughtful comments and assistance with this article.

In light of some very high-profile corporate inversions,¹ the U.S. Congress added section 7874 to the Internal Revenue Code as part of the American

¹McDermott International, Helen of Troy, Triton Energy, Tyco International, Fruit of the Loom, Cooper Industries, and Ingersoll-Rand. For purposes of this article, an inversion includes a stock inversion, an asset inversion, and various combinations thereof.

In a stock inversion, the U.S. parent corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. parent corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign parent corporation. The U.S. parent corporation's shareholders receive

(Footnote continued in next column.)

shares of the foreign corporation and are treated as having exchanged their U.S. parent corporation shares for the shares of the new foreign parent corporation. An asset inversion reaches a similar result, but through a direct merger of the U.S. parent corporation into a new foreign corporation, among other possible forms.

An inversion transaction may be accompanied or followed by further restructuring of the corporate group. For example, in a stock inversion, to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation may transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations. In addition to removing foreign operations from the U.S. taxing jurisdiction, the corporate group may derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various earnings stripping or other transactions.

Inversion transactions may give rise to immediate U.S. tax consequences at the U.S. shareholder level, the corporate level, or both, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognize gain (but not loss) under section 367(a) based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the U.S. parent corporation shares surrendered. In asset inversions, the U.S. parent corporation generally recognizes gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally do not recognize gain or loss, assuming the transaction meets the requirements of a reorganization under section 368.

(Footnote continued on next page.)

Jobs Creation Act of 2004 (P.L. 108-357).² In its harshest form, section 7874 treats the new foreign parent (the “surrogate foreign corporation”) as a U.S. corporation for all purposes of the code.³ In its milder form, section 7874 denies the use of some tax attributes to offset the inversion gain.⁴

Specifically, if after an inversion the former shareholders of the U.S. corporation own 60 percent or more of the shares of the new foreign parent corporation, but less than 80 percent of the shares of the new foreign parent, then section 7874 applies in its milder form and some tax attributes cannot be used to offset the inversion gain.⁵ If after an inversion the former shareholders of the U.S. corporation own 80 percent or more of the shares of the new foreign parent corporation, then section 7874 applies its harshest form, that is, the foreign corporation is treated as a U.S. corporation for all purposes of the code.⁶

For section 7874 to apply, three conditions must exist:

- a U.S. corporation becomes a subsidiary of a foreign corporation or otherwise transfers substantially all of its property to a foreign corporation (that is, the U.S. corporation inverts);
- the shareholders of the U.S. corporation end up with 60 percent or more of the vote or value of the shares of the new foreign parent corporation; and

The transfer of foreign subsidiaries or other assets to the new foreign parent corporation also may give rise to U.S. tax consequences at the corporate level (for example, gain recognition and earnings and profits inclusions under sections 301, 304, 311(b), 367, 1001, 1248, or other provisions).

Were it not for section 7874, the tax on any income recognized as a result of those restructurings could be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

²See S. Rep. No. 108-192, 108 Cong., 2d Sess., at 142 (Nov. 7, 2003): “The Committee believes that inversion transactions resulting in a minimal presence in a foreign country of incorporation are a means of avoiding U.S. tax and should be curtailed. In particular, these transactions permit corporations and other entities to continue to conduct business in the same manner as they did prior to the inversion, but with the result that the inverted entity avoids U.S. tax on foreign operations and may engage in earnings-stripping transactions to avoid U.S. tax on domestic operations.” The Senate Finance Committee further stated that it believes “inversion transactions (involving 80 percent or greater identity of stock ownership) have little or no non-tax effect or purpose and should be disregarded for U.S. tax purposes.” *Id.*

³Section 7874(a) and (b).

⁴Section 7874(a).

⁵*Id.*

⁶*Supra* note 3.

- the new foreign parent corporation, along with all of its subsidiaries (the expanded affiliated group, or EAG),⁷ does not have “substantial business activities” in its country of incorporation when compared with the total business activities of the EAG.⁸

Given the need for “substantial business activities” in the new foreign parent’s country of incorporation, section 7874 appears to represent an absolute bar to the typical inversion that involves the replacement of the U.S. parent with a tax haven parent (that is, a parent company that is organized under the laws of Bermuda, Barbados, the Cayman Islands, or similar jurisdictions). That said, the question arises whether, given the right fact pattern, an inversion into Ireland, Switzerland, or the United Kingdom (an “inversion lite”) is still possible.

Consider whether substantial business activities exist in Ireland, the United Kingdom, and Switzerland, respectively, for the following multinational corporations after their inversions.

Flanagan Software Ltd.

Flanagan Software Ltd. (Flanagan) began as an Irish company that developed software, which it sold throughout the world. Flanagan owned three subsidiaries: another Irish company that performed research and development and manufacturing (stamping of disks and packaging) on behalf of the group; a U.S. corporation that marketed and sold Flanagan’s software in the United States; and a U.K. company that marketed and sold Flanagan’s software throughout the rest of the world.

Several years ago, Flanagan approached various U.S. venture capitalists about the possibility of raising additional capital. To accomplish that financing, the shareholders transferred their shares in Flanagan to a newly formed U.S. holding company. Subsequently, the new U.S. holding company was taken public and its shares listed on NASDAQ. Faced with outrageous costs for Securities and Exchange Commission reporting, Sarbanes-Oxley compliance, and its NASDAQ listing, Flanagan would now like to exit the United States by replacing its U.S. holding company with a new Irish holding company in an asset inversion.⁹ The new Irish

⁷The EAG includes all corporations in an affiliated group under section 1504(a), but without regard to section 1504(b)(3) (which excludes foreign corporations) and substituting a more than 50 percent vote and value test for the at least 80 percent vote and value test. Section 7874(c)(1).

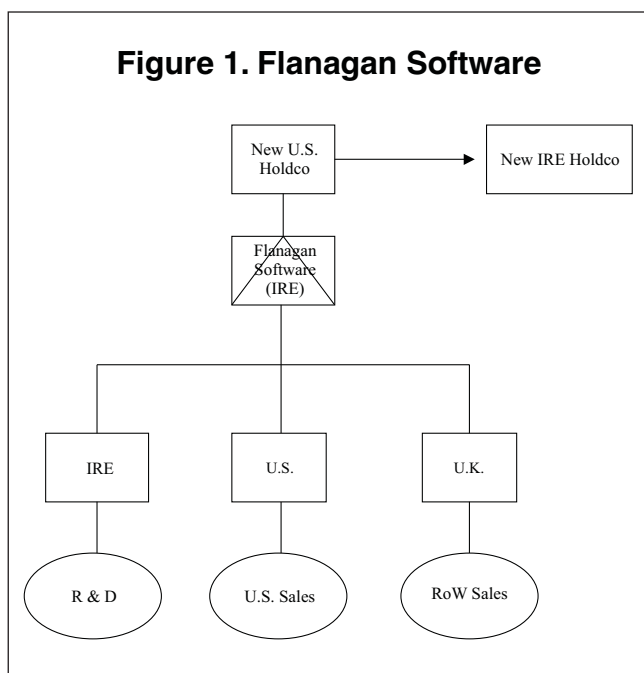
⁸*Supra* note 4.

⁹The authors are not securities experts and do not intend to suggest that an inversion is necessary or sufficient to escape U.S. securities regulations.

holding company would be listed on the AIM of the London Stock Exchange.¹⁰

After the inversion, Flanagan's R&D and manufacturing teams based in Ireland will make up approximately 12 percent of group employees, which includes the senior management of the R&D and manufacturing teams. Approximately 1 percent of Flanagan's sales income derives from sales to end-users in Ireland. Finally, approximately 8 percent of Flanagan's total tangible assets and 50 percent of its intangible business assets will be located in Ireland. In anticipation of the inversion, a significant number of senior managers have been relocated back to Ireland.

See Figure 1.



Ponda Worldwide Outsourcing Ltd.

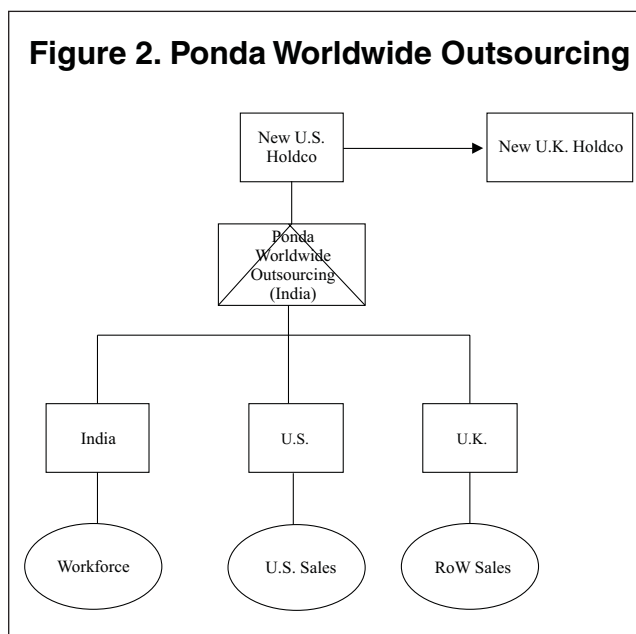
Ponda Worldwide Outsourcing Ltd. (Ponda) began as an Indian company that provided outsourcing solutions to worldwide customers. Like Flanagan, Ponda owned three subsidiaries: another Indian company that employed the company's workforce; a U.S. corporation that marketed and sold Ponda's outsourcing solutions in the United States; and a U.K. company that marketed and sold Ponda's outsourcing solutions throughout the rest of the world.

Like Flanagan Software, several years ago Ponda approached various U.S. venture capitalists about

the possibility of raising additional capital. To accomplish that financing, the shareholders transferred their shares to a newly formed U.S. holding company. Subsequently, the new U.S. holding company was taken public and its shares listed on NASDAQ. Faced with outrageous costs for Securities and Exchange Commission reporting, Sarbanes-Oxley compliance, and its NASDAQ listing, Ponda would now like to exit the United States by replacing its U.S. holding company with a new U.K. holding company in an asset inversion. The new U.K. holding company would be listed on the AIM of the London Stock Exchange.

After the inversion, Ponda's non-U.S. marketing and sales force teams and other employees based in the United Kingdom will make up approximately 15 percent of group employees. Approximately 11 percent of Ponda's sales income derives from sales to end-users in the United Kingdom. Finally, 10 percent of Ponda's total tangible assets are located in the United Kingdom. All senior managers will remain in the United States after the inversion.

See Figure 2.



Schneider Medical Device Corporation

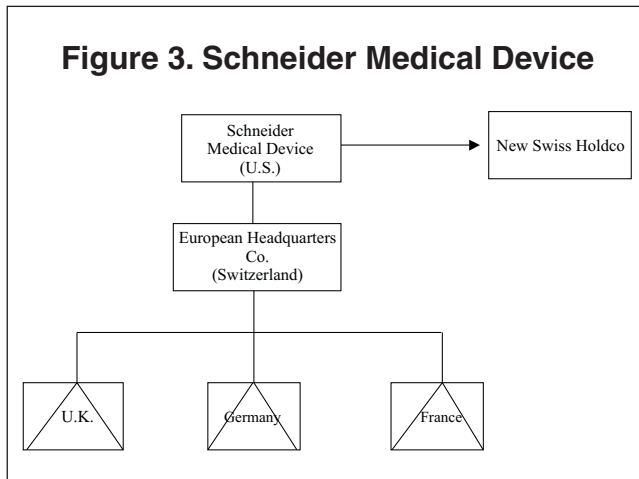
Schneider Medical Device Corporation (Schneider) is a U.S. publicly traded corporation that develops, produces, and sells various medical devices throughout the world. Several years ago, Schneider established a significant headquarters company in Switzerland. The Swiss headquarters company became responsible for all Schneider's operations outside the United States.

Faced with outrageous costs for Securities and Exchange Commission reporting, Sarbanes-Oxley

¹⁰In this case and in the next two cases, there will be perfect identity of shareholders before and after the inversion.

compliance, and its NASDAQ listing, Schneider would like to exit the United States by replacing its U.S. parent company with a new Swiss parent in an inversion. The new Swiss parent company would be listed on the AIM of the London Stock Exchange. The Swiss headquarters company houses approximately 25 percent of the company's total employees, including several senior managers. Approximately 2 percent of Schneider's sales income derives from sales to end-users in Switzerland. Approximately 15 percent of Schneider's tangible assets and 80 percent of its intangible assets are located in Switzerland. Although Schneider is a public company, Swiss investors have retained a significant share in the company. Several managers resident in Switzerland hold equity stakes as well. In total, 15 percent of the company is owned by Swiss residents.

See Figure 3.



For Flanagan Software, Ponda Worldwide Outsourcing, or Schneider Medical Device to avoid the application of section 7874 to their planned inversions, each must have the requisite substantial business activities in the new foreign parent's country of incorporation. In that regard, on June 5, 2006, the Treasury Department and the Internal Revenue Service issued temporary and proposed regulations under section 7874 that, *inter alia*, set forth standards for determining whether an inverted group (the EAG) has the requisite substantial business activity in the new foreign parent's country of incorporation.¹¹

¹¹T.D. 9265 (June 5, 2006) (for the text of the temporary regulations, see *Doc 2006-10734* or *2006 WTD 108-8*). The regulations also set forth rules regarding indirect acquisitions of property, identification and treatment of stock, options, and conversion rights for purposes of the 80 percent and 60 percent ownership tests, publicly traded partnerships, and

Treas. Reg. Section 1.7874-2T(d)

Treas. reg. section 1.7874-2T(d) provides both a facts and circumstances test and a safe harbor test to determine whether an EAG has substantial business activities in the acquiring foreign entity's country of incorporation compared with the total business activities of the EAG. The Treasury Department and the IRS believe that this dual approach provides taxpayers with the certainty of an objective and clear safe harbor, while preserving the ability of the taxpayer to contend, in a case that is not within the scope of the safe harbor, that the EAG has a meaningful and bona fide business presence in the relevant foreign country.¹²

Facts and Circumstances Test

Under the facts and circumstances test, the determination of whether the EAG has substantial business activities in the foreign country, when compared with the EAG's total business activities, is made on the basis of all the facts and circumstances.¹³ However, some factors, which are described later, are not taken into account in making that determination.¹⁴

For the EAG to have substantial business activities in the foreign country when compared with the EAG's total business activities, there is no minimum percentage of its total business activities (regardless of how measured) that must be in the foreign country.¹⁵ However, for the determination of substantiality to be made on the basis of a comparison with the total business activities, various "relevant factors"¹⁶ must be evaluated. In weighing the relevant factors, it is possible that the EAG's business activities in a particular country would be substantial when compared with the EAG's total business activities, but the identical business activities of another EAG in the same country would not be substantial when

mechanics regarding the operation of section 7874. Previously, the Treasury Department and the IRS issued temporary and proposed regulations under section 7874 that set forth rules to disregard affiliate-owned stock for the 80 percent and 60 percent ownership tests in determining whether a corporation is a surrogate foreign corporation under section 7874(a)(2)(B). See *Treas. reg. section 1.7874-1T* (T.D. 9238 (Dec. 27, 2005)).

¹²T.D. 9265, Preamble. It is currently unclear whether the IRS will issue private letter rulings on the issue of whether substantial business activity exists in the relevant foreign country under the facts and circumstances test.

¹³Treas. reg. section 1.7874-2T(d)(1)(i).

¹⁴*Id.*

¹⁵*Id.*

¹⁶*Id.*

(Footnote continued in next column.)

compared with the total business activities of that EAG. That could occur if the total business activities of the second EAG are more extensive than the total business activities of the first EAG.¹⁷

In determining whether the EAG has substantial business activities in the relevant foreign country when compared with the EAG's total business activities, the relevant factors include (but are not limited to):

- *Historical presence.* The conduct of continuous business activities in the foreign country by the EAG members before the acquisition.
- *Operational activities.* Business activities of the EAG in the foreign country occurring in the ordinary course of the active conduct of one or more trades or business, involving:
 - property located in the foreign country that is owned by members of the EAG;
 - performance of services by individuals in the foreign country who are employed by members of the EAG; and
 - sales to customers in the foreign country by EAG members.
- *Management activities.* The performance in the foreign country of substantial managerial activities by EAG members' officers and employees who are based in the foreign country.
- *Ownership.* A substantial degree of ownership of the EAG by investors resident in the foreign country.
- *Strategic factors.* The existence of business activities in the foreign country that are material to the achievement of the EAG's overall business activities.¹⁸

The presence or absence of any factor, or of a particular number of factors, is not determinative.¹⁹ Moreover, the weight given to any factor depends on the particular case.²⁰ Any assets, activities, or income attributable to a transfer or transfers that are disregarded under section 7874(c)(4) are not considered to be relevant factors.²¹ Also, the relevant

factors exclude any assets that are temporarily located in a foreign country at any time as part of a plan with a principal purpose of avoiding the purposes of section 7874.²²

Importantly, as discussed below, the term "group assets" does not include intangible assets. Although not specifically included among the factors that will not be considered, the preamble to the regulations makes clear that "the IRS and Treasury Department believe that the statutory phrase 'business activities' ordinarily does not include passive investment activities and related income and assets."²³ However, the preamble further asserts that "intangibles that are used in the course of active business operations by EAG members will normally be accorded due weight by the IRS in the application of the all-facts-and-circumstances test."²⁴ Thus, it appears that trademarks, copyrights, patents, and other intellectual property actively used by the EAG in the relevant foreign country are appropriate to consider in the facts and circumstances test.

The Safe Harbor Test

Under the safe harbor test, the EAG will be considered to have substantial business activities after the acquisition in the relevant foreign country, when compared with the EAG's total business activities, under the following conditions:

- *Employees.* After the acquisition, the group employees based in the foreign country account for at least 10 percent (by head count and compensation) of total group employees.
- *Assets.* After the acquisition, the total value of the group assets located in the foreign country is at least 10 percent of the total value of all group assets.
- *Sales.* During the testing period (defined below), the group sales made in the foreign country accounted for at least 10 percent of total group sales.²⁵

Definitions

For purposes of both the facts and circumstances test and the safe harbor test:

country that were transferred under a plan with a principal purpose of avoiding section 7874.

²²*Id.*

²³T.D. 9265.

²⁴*Id.*

²⁵Treas. reg. section 1.7874-2T(d)(2). Consideration was given to the use of thresholds higher than the 10 percent used in the safe harbor rule. However, based on comments received, the IRS and Treasury believe that 10 percent is a reasonable threshold. See T.D. 9265.

¹⁷*Id.*

¹⁸Treas. reg. section 1.7874-2T(d)(1)(ii).

¹⁹*Id.*

²⁰*Id.*

²¹Treas. reg. section 1.7874-2T(d)(1)(iii). Congress intended to prevent taxpayers from avoiding section 7874 through tax-motivated transfers of properties or liabilities by providing in section 7874(c)(4) that those transfers will be disregarded. Therefore, in analyzing the facts and circumstances to determine whether an EAG's business activities in the relevant foreign country are substantial, it is necessary to disregard any assets, liabilities, or activities in the foreign

(Footnote continued in next column.)

- “Group employee” means a common law employee of one or more members of the EAG who worked full time (meaning normally 35 or more hours per week) throughout the testing period. An independent contractor performing activities on behalf of an EAG member is not a group employee. A group employee is considered to be based in a country only if the group employee spent more time providing services in that country than in any other country during the testing period and continues to provide services in that country immediately after the acquisition.²⁶
- “Group assets” means tangible property used or held for use in the active conduct of a trade or business by a member of the EAG. An item of tangible property is considered to be located in a country only if the item was physically present in that country for more time than in any other country during the testing period. Value is determined on a gross basis (that is, without reduction for liabilities) after the acquisition. Group assets are disregarded if acquired or transferred as part of a plan with a principal purpose of avoiding the application of section 7874. Also, *intangible assets are not taken into account (in either the numerator or denominator) in calculating the amount of group assets.*²⁷
- “Group sales” means sales and the provision of services by members of the EAG, measured by gross receipts from those sales and services, in U.S. dollars. Group sales are considered to be made in a particular country only if the services, goods, or other property transferred by those sales are sold for use, consumption, or disposition in that country.²⁸

²⁶Treas. reg. section 1.7874-2T(d)(3)(i). If compensation is denominated in a foreign currency, the compensation is translated into U.S. dollars using the weighted average exchange rate for the tax year (as defined in Treas. reg. section 1.989(b)-1).

²⁷Treas. reg. section 1.7874-2T(d)(3)(ii). The IRS and Treasury specifically excluded intangible assets from the definition of group assets, even though intangibles may be used in the course of active business operations. The reason for excluding intangibles is that they frequently present difficult factual issues regarding their use, value, and location. Therefore, their inclusion in the definition of group assets for purposes of the safe harbor would introduce a significant element of uncertainty in many cases about the application of the safe harbor rule. Given that the purpose of the safe harbor rule is to provide a bright-line test, it was decided that the definition of group assets should not include intangibles. T.D. 9265.

²⁸Treas. reg. section 1.7874-2T(d)(3)(iii). If gross receipts are denominated in a foreign currency, the gross receipts are

(Footnote continued in next column.)

- “Testing period” means the 12-month period ending on the last day of the EAG’s monthly or quarterly management accounting period in which the acquisition is completed.²⁹
- “After the acquisition” means the last day of the testing period.³⁰

Also, for purposes of the facts and circumstances test and the safe harbor test, if one or more members of the EAG owns capital or profits interests in a partnership, the proportionate amount of activities, employees, assets, income, and sales of that partnership are considered to be activities, employees, assets, income, and sales of the member or members of the EAG. A partner’s proportionate share for these purposes is determined under the rules and principles of sections 701 through 706 and the regulations under those sections.³¹

Examples

The regulations provide five examples of inversions that are analyzed under the facts and circumstances test.³²

Example 1: Group employees based in Country A regularly perform administrative back-office services for other EAG members, and they regularly provide customer service globally via telephone and e-mail from a communications center located in Country A.

After the inversion, less than 2 percent of group employees are based in Country A; less than 3 percent of group sales were made in Country A; and approximately 2 percent of total group assets are located in Country A. None of the group’s senior managers are based in Country A.

In light of all the facts and circumstances, the regulations conclude that, after the acquisition, the EAG *does not have* substantial business activities in Country A.

Example 2: Group members own and have continuously operated a manufacturing facility and warehouses in Country A for several years before the acquisition. The manufacturing facility produces approximately 2 percent of the group’s production of finished goods. Group employees based in Country A regularly perform back-office services for other group members.

translated into U.S. dollars using the weighted average exchange rate for the tax year (as defined in Treas. reg. section 1.989(b)-1).

²⁹Treas. reg. section 1.7874-2T(d)(3)(iv).

³⁰*Id.*

³¹Treas. reg. section 1.7874-2T(d)(3)(iv).

³²Treas. reg. section 1.7874-2T(d)(4).

After the inversion, less than 5 percent of group employees are based in Country A; less than 2 percent of group sales were made in Country A; and approximately 4 percent of total group assets are located in Country A. None of the group's senior managers are based in Country A.

In light of all the facts and circumstances, the regulations conclude that, after the acquisition, the EAG *does not have* substantial business activities in Country A.

Example 3: The EAG's main line of business is financial services. Group employees based in Country A regularly perform back-office services for group members.

After the inversion, less than 5 percent of group employees are based in Country A; less than 3 percent of group sales were made in Country A; and approximately 10 percent of total group assets are located in Country A — largely because group members had purchased a substantial portfolio of commercial and residential real estate in Country A during the 24 months preceding the acquisition. The real estate is managed by an unrelated independent agent and was not acquired under a strategic plan for any of the group's lines of business, nor are the group's business activities in Country A material to the achievement of the EAG's overall business objectives. Most of the group's senior managers are based outside Country A.

Once more, in light of all the facts and circumstances, the regulations conclude that, after the acquisition, the EAG *does not have* substantial business activities in Country A.

Example 4: The EAG parent corporation acquired a larger domestic corporation and its subsidiaries under a merger agreement that was prompted by a third group's attempted hostile takeover of the domestic target. After the merger, the EAG parent is more than 60 percent owned by former shareholders of the domestic target corporation. Before the merger, the stock of each parent corporation was publicly traded in its respective country of incorporation. After the merger, the EAG parent stock is publicly traded on stock exchanges in both the relevant country and the United States. The two groups were competitors in the same global line of business for many years preceding the merger.

After the inversion, approximately 11 percent of group employees are based in Country A; approximately 7 percent of group sales are expected to be made in Country A; and approximately 10 percent of total group assets are located in Country A. EAG employees based in Country A perform all of the functions involved in the EAG's overall business activities, including headquarters and senior management functions.

In light of all the facts and circumstances, the regulations conclude in this case that, after the acquisition, the EAG *does have* substantial business activities in Country A.

Example 5: The controlling shareholders and the senior managers of the EAG (an advanced technology corporation) are resident in Country A. The controlling shareholders originally established a domestic corporation (DC), which established its head office in City B in the United States, to hire research personnel who had been trained at a local leading institute of technology in City B. DC hired 10 researchers who worked at DC's premises in City B. DC also established FS, a wholly owned Country A subsidiary, which hired research personnel in Country A to perform research and product development functions at FS's premises in Country A. Subsequently, the senior managers and controlling shareholders adopted a new business strategy, closed the U.S. operations, and transferred DC's business and stock in FS to FP, a new Country A corporation, with the result of centering the EAG's business in Country A. Under the new strategy, DC terminated the employment of seven researchers and the lease on its City B premises, relocated the other three researchers from City B to Country A, and transferred its remaining assets, including the stock in FS, to FP in exchange for more than 80 percent of FP's stock. The example does not state what percentage of sales derive from end-users in Country A. After the inversion, substantially all group employees are based in Country A and substantially all total group assets are located in Country A.

In light of all the facts and circumstances, the regulations conclude that, after the acquisition, the EAG *does have* substantial business activities in Country A.

The examples are summarized in Table 1.

Flanagan, Ponda, and Schneider Revisited

As noted above, whether Flanagan Software, Ponda Worldwide Outsourcing, and Schneider Medical Device will be able to avoid the application of section 7874 regarding their planned inversions is solely dependent on whether they have the requisite substantial business activities in the new foreign parent's country of incorporation.

Flanagan Software

After the inversion, Flanagan's R&D and manufacturing teams based in Ireland will make up approximately 12 percent of group employees, which include the senior management of the R&D and manufacturing teams. Also, several senior managers who had moved to the United States (during the U.S. financing) have returned to Ireland. Although

only 1 percent of Flanagan's sales income is from sales to end-users in Ireland and only 8 percent of the company's total tangible assets are in Ireland, 50 percent of its intangible business assets will be located in Ireland.

Considering the historical presence of Flanagan's R&D and manufacturing activities and management, the significant number of group employees in Ireland, the significant number of senior managers in Ireland (including those who have recently returned), and the significant presence of intangible assets in Ireland, it should be found under the facts and circumstances test that Flanagan has substantial business activities in Ireland when compared with the EAG's total business activities. Therefore, section 7874 should not be an impediment to Flanagan's inversion into Ireland.

Ponda Worldwide Outsourcing

Both before and after its inversion, Ponda will have approximately 15 percent of group employees located in the United Kingdom. Also, approximately 11 percent of Ponda's sales income is attributable to sales to end-users in the United Kingdom, and 10 percent of its total tangible assets are located in the United Kingdom. Under these facts, Ponda meets the safe harbor test because 10 percent or more of each of its group employees, group sales, and group assets are in the United Kingdom. Therefore, section 7874 will not be an impediment to Ponda's inversion into the United Kingdom.

Schneider Medical Device

Recall that Schneider had a Swiss headquarters company before its plan for inversion. Both before

and after the inversion, approximately 25 percent of the company's total employees, including several senior managers, are in Switzerland. Approximately 2 percent of Schneider's sales income is (and is expected to continue to be) from sales to end-users in Switzerland. Approximately 15 percent of Schneider's tangible assets and 80 percent of its intangible assets are located in Switzerland. Finally, 15 percent of the company is owned by Swiss residents.

Considering the historical presence of the Swiss headquarters company, the presence of senior managers in Switzerland, the significant presence of intangible assets in Switzerland, and the large percentage of Swiss ownership of the company, it should be found under the facts and circumstances test that Schneider has substantial business activities in Switzerland when compared with the EAG's total business activities. Therefore, section 7874 should not be an impediment to Schneider's inversion into Switzerland.

Conclusion

Section 7874 was enacted (and Treas. reg. section 1.7874-2T(d) was promulgated) to limit inversions to tax havens when there is little or no change in control of the corporate group. Although inversions to tax havens may no longer be possible, Treas. reg. section 1.7874-2T(d) leaves open the possibility of an inversion "lite" — that is to say, a U.S.-based multinational corporate group may invert to a lower tax jurisdiction such as Ireland, Switzerland, or the United Kingdom (and thus leave behind those outrageous Securities and Exchange Commission reporting and compliance costs). ♦

Table 1. Examples Under the Facts and Circumstances Test^a

	Facts and relevant factors	Percent attributable to relevant country			Presence of substantial business activities
		Employees	Sales	Assets	
Ex. 1	<p>(i) EAG employees based in Country A regularly perform administrative, back-office services for other EAG members, and regularly provide customer service globally via telephone and e-mail at a communications center located in the relevant country.</p> <p>(ii) None of the EAG's senior managers are based in the relevant country.</p>	<2	<3	2	No
Ex. 2	<p>(i) EAG members own and have continuously operated a manufacturing facility and warehouses in the relevant country for several years prior to the acquisition, producing 2 percent of the total value of the EAG's production of finished goods in the 12-month period ending on the date of the acquisition.</p> <p>(ii) EAG employees based in the relevant country regularly perform back-office services for other EAG members.</p> <p>(iii) None of the EAG's senior managers are based in the relevant country.</p>	<5	<2	4	No
Ex. 3	<p>(i) The EAG provides financial services.</p> <p>(ii) EAG employees based in the relevant country regularly perform back-office services for other EAG members.</p> <p>(iii) High value of total EAG assets due to purchases of real estate in the relevant country during the 24 months preceding the inversion.</p> <p>(iv) The real estate is managed by an unrelated independent agent and was not acquired under a strategic plan for any of the EAG's lines of business.</p> <p>(v) The EAG's business activities in the relevant country are not material to the achievement of the EAG's overall business objectives.</p> <p>(vi) Most of the EAG's senior managers are based outside the relevant country.</p>	<5	<3	10	No
Ex. 4	<p>(i) The EAG foreign parent corporation acquired a larger domestic corporation and its subsidiaries under a merger agreement; after the merger, the EAG foreign parent is more than 60 percent owned by former shareholders of the domestic target corporation.</p> <p>(ii) Before the merger, the stock of each parent corporation was publicly traded in its respective country of incorporation; after the merger, the EAG foreign parent stock is publicly traded on stock exchanges in both the relevant country and the United States.</p> <p>(iii) The two groups were competitors in the same global line of business for many years preceding the merger.</p> <p>(iv) The merger was prompted by a third group's attempted hostile takeover of the domestic target corporation and its subsidiaries.</p> <p>(v) EAG employees based in the relevant country perform all of the functions involved in the EAG's overall business activities, including headquarters and senior management functions.</p>	11	7	10	Yes

Table 1. Examples Under the Facts and Circumstances Test^a (continued)

	Facts and relevant factors	Percent attributable to relevant country			Presence of substantial business activities
		Employees	Sales	Assets	
Ex. 5	<p>(i) The EAG's business involves advanced technology.</p> <p>(ii) The controlling shareholders of the EAG parent corporation, and the senior managers of the EAG, are resident in Country A.</p> <p>(iii) The controlling shareholders originally established domestic corporation DC, which established its head office in City B in the United States, to hire research personnel who had been trained at a local leading institute of technology in City B. DC hired 10 researchers who worked at DC's premises in City B.</p> <p>(iv) DC also established FS, a wholly owned Country A subsidiary, which hired research personnel in Country A to perform research and product development functions at FS's premises in Country A.</p> <p>(v) Subsequently, the senior managers and controlling shareholders adopted a new business strategy, closed the U.S. operations, and transferred DC's business and stock in FS to FP, a new Country A corporation, with the result of centering the EAG's business in Country A. Under the new strategy, DC terminated the employment of seven researchers and the lease on its City B premises, relocated the other three researchers from City B to Country A, and transferred its remaining assets, including the stock in FS, to FP in exchange for more than 80 percent of the stock of FP.</p>	Substantially all	N/A	Substantially all	Yes

^aTreas. reg. section 1.7874-2T(d)(4).