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D.4 Corporate Inversions

Prepared by the Direct Investment Task Team (DITT)

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D.4 Corporate Inversions[1]

Corporate inversions can have a noticeable effect on the cross-border statistics of both the economy of the new foreign parent company and the economy of the inverter. This is why they currently pose various analytical, conceptual, and practical challenges: (i) reduce the analytical usefulness of direct investment statistics because of the motivation by factors other than those conventionally ascribed to direct investors; (ii) may have large effects on the international and national accounts, generating misleading patterns and complicating consistent treatment under the current guidelines; and (iii) can be difficult to define and identify them. This guidance note discusses and proposes three alternatives to address the conceptual and practical issues posed by corporate inversions as well as a definition of corporate inversion, for consideration.

SECTION I: THE ISSUE

BACKGROUND

1. **Some multinational enterprises (MNEs) geographically locate (or re-locate) their economy of legal residence to reduce their global tax liability, which is known as a "corporate inversion."** The inversion strategy often involves an agreement between corporations in two countries. A corporation ("the inverter") in one economy often merges with a corporation ("the new foreign parent company") that is headquartered in a lower-tax economy. The underlying financial transactions typically involve an exchange of shares and an agreement to designate the lower-tax economy as the legal residence of the combined entity. There is usually no change in the geographical allocation of headquarter functions; at most some or just a few board meetings are held in the economy of the new foreign parent company. Generally, a direct investment is created from the economy of the new foreign parent company to the economy of the inverter and a portfolio relationship is created by the economy of the inverter to the economy of the new foreign parent company, as shareholders in the inverter are converted to shares in the new foreign parent company.

2. **The incidence of corporate inversions is not widespread geographically but, contrary to popular perception, it is not overwhelmingly a U.S. phenomenon.** A recent study found that the United States accounted for only 21 percent of the dollar value of a large sample of inversions in the Organisation for Economic Co-operation and Development (OECD) countries (Col et al. (2019)). Other important home countries identified by the authors are Australia, Canada, France, Germany, Italy, Netherlands, Spain, Sweden, Switzerland, and the United Kingdom.

3. **Corporate inversions might have a noticeable effect on the macroeconomic statistics of both the economy of the new foreign parent company and the economy of the inverter, with the magnitude of the effect depending on the ratio between the size of the inverting company and the size of the economy.** Two large economies that are popular for hosting new parent companies are Ireland and the Netherlands. Fitzgerald (2015) estimates that the undistributed profits of resident

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corporate inversions in 2014 was 6.9 billion euro, which, represents 11.0 percent of Ireland's primary income receipts in that year.[2] Nelisse and Hiemstra (2019) estimate that resident corporate inversions contributed 9.1 billion euro to Netherland's primary income balance in 2017, which represents 3.4 percent of the economy's primary income receipts in that year. Among major home countries, Hanson et al. (2015) estimate that in 2012 corporate inversions accounted for 5.4 percent of the direct investment equity position in the United States. Although recent tax law changes appear to have halted new inversions by U.S. corporations, the companies that have already inverted do not appear to be redomiciling (Atkinson and Hanson (2020)). For the United Kingdom, Hamroush and Hardie (2016) find "little evidence to suggest that companies re-domiciling their headquarters overseas have been having an adverse effect on UK FDI statistics in recent years." For Italy, corporate inversion is a relevant phenomenon. In recent years, various Italian MNEs have relocated abroad their economy of legal residence, usually to the Netherlands, reflecting tax and legal convenience (Federico et al. (2018)). Unlike for the United States, the corporate inversion trend has not diminished over time for Italy.

4. **For an inversion through the exchange of shares,** the inverting company essentially pays a liquidating dividend to its shareholders, who then make a portfolio investment in the new foreign parent company at the same value. The new foreign parent company essentially uses these funds to make a direct investment in the inverting company. Corporate inversion might be also completed through other types of restructuring, which may involve different accounting treatments. Corporate inversions are not covered in the OECD *Benchmark Definition of Foreign Direct Investment, fourth edition,* 2008 (*BD4)*.

5. **Corporate inversions can have large effects on the international and national accounts, which can result in international transactions and positions that are misleading and that are not treated consistently.** Under current guidelines, the different treatment of reinvested earnings on direct investment and portfolio investment will tend to reduce net primary income receipts and the higher-level national accounting aggregates that include them in their derivation—corporate profits and total gross national income.[3] Annex II provides relevant details on the effect of inversions on selected aggregates of the US national income and product accounts.[4]

6. **It is doubtful that direct investment under a corporate inversion conveys the same benefits to the recipient economy as traditional direct investment, especially when key headquarters functions remain in the economy of the inverting company.** This special nature of inversions is underlined in the *BPM6*, paragraph 8.20, which states that "because inversions can involve large values in the financial account but with little or no movement in resources, there may be analytical interest in separating them from other direct investment. If not prevented by confidentiality, supplementary data could be provided."

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[2] More up-to-date statistics are available on the CSO website at https://www.cso.ie/en/releasesandpublications/in/rpibp/redomiciledplcsintheirishbalanceofpayments2015/

[3] This issue is being discussed separately under the Financial and Payments Systems Task Team guidance note F.2 "Asymmetric treatment of retained earnings between direct and portfolio investment and potential extension to domestic relationships."

[4] Likewise, Ireland's CSO publishes annual Institutional Sector Accounts for an analysis of Inversions (known as Redomiciled Corporations) through the sequence of accounts; see https://www.cso.ie/en/releasesandpublications/ep/p-isanff/institutionalsectoraccountsnon-financialandfinancial2019/nfa/curtac/

7. **As a practical matter, it can be difficult to identify corporate inversions and, it may even be difficult to define them such that all types of restructuring are covered.** Cortes et al. (2015) identify three classes of inversions for U.S. companies: (i) *Pure inversion*: The inverting company creates a foreign entity to serve as the legal head office while keeping the headquarters functions in the United States; (ii) *Restructuring inversion*: The inverting company becomes foreign-owned through a merger, leveraged buy-out, bankruptcy, or spin-off; and (iii) *Born inverted*: When a new domestic company is established along with a foreign entity as owner but headquarters functions remaining in the United States.

8. **Since corporate inversions mainly involve listed groups, public information on these transactions is widely available (e.g., company press releases and reports).** Recording corporate inversion transactions in external sector statistics might nonetheless be sometimes a challenge for the compiler (especially in the case of complex corporate restructurings) and might benefit, therefore, from a more detailed guidance in the manuals.

9. **There is also the conceptual issue of how to treat subsequent acquisitions of companies in the country of the inverter by the new foreign parent company.** Are the domestic companies that they acquire also inverting, and are these transactions likely to be recorded in the media? Also, does it ever happen that over time, the new foreign parent company begins to act more like a real HQ?

ISSUES FOR DISCUSSION

10. **In order to address the conceptual and practical issues outlined above three alternatives have been identified for the treatment of corporate inversions.** The alternatives are described below.

I. Alternative 1 (A1)

11. **Maintain the methodological and presentational status quo.** This is supported by conceptual and practical considerations. Conceptually, it is not clear that the definition of a corporate inversion offered in paragraph one is sufficiently precise to enable compilers to separately identify inversions, and, even if the initial inversion can be defined, as noted in paragraph nine above, it is not clear that subsequent expansions/acquisitions by the inverted direct investment enterprise should be counted as inversion-related investments. Practically, as noted earlier in paragraph seven, it can be difficult to track some corporate inversions and, even if the inversion can be identified, it may not be possible to publish statistics on these transactions because of data confidentiality constraints. Also, the number of countries whose direct investment statistics are affected appears to be small. Under this alternative, there is no recommendation to treat differently, or publish separate statistics on, direct investments related to corporate inversions in a balance of payments context. Countries that host inversion-related DI might consider quantifying this activity in the context of their Activities of Multinational Enterprises (AMNE) statistics.

II. Alternative 2 (A2)

12. **Strengthen the current guidance on publishing supplementary detail on corporate inversions and define corporate inversions.** Notwithstanding the practical challenges, the differences in motivation and impacts between inversion-related direct investments and traditional direct investments, noted in paragraph 6 above, suggest the benefits of publishing separate statistics on inversion-related

direct investments as a supplemental item. As noted in paragraph 8.20 of the *BPM6*, inversion-related direct investments tend to “involve large values in the financial account but with little or no movement in resources” unlike traditional direct investments. The same paragraph encourages the publication of supplementary detail on corporate inversions, possibly including DI flows, positions, and income, if feasible and if the values are large. The guidance note proposes that the language be strengthened by offering a richer description of corporate inversions. The practical difficulties with identifying and tracking corporate inversions are acknowledged but seem to be manageable. In addition, since this alternative does not impact the aggregates but is intended to provide information to enhance the interpretability of the statistics for users, some judgment on the part of the compiler in implementing it is warranted as they know most about the transaction.

13. **Identifying corporate inversions will require some objective criteria, such as those employed in the methods codified in elements of German law (*Sitztheorie*) that use simple metrics to determine the “true seat” of a corporation (Ebke (2002))**. The economy of the *true* corporate parent could be based on one or more of the following criteria (*Anknüpfungspunkte*):

a) The location where central management decisions are routinely made;

b) The location where the corporation was founded;

c) The nationality of the majority of the corporation’s shareholders or of the firm’s executive officers;

d) The corporation’s principal place of business or the state that is most strongly affected by the activities of the corporation (e.g., the geographic center of the corporation’s global labor force).

Desai (2008) argues that the home economy of a multinational should be based on “critical managerial decision-marking and the associated headquarters functions” and that this connection has been lost because “firms are redefining their homes by unbundling their headquarters functions and reallocating them opportunistically across nations.” In Eurostat’s Structural Business Statistics, the term “Global Decision Centre” is used to designate where the “true” center of control for these corporations is resident. Additional guidance on defining corporate inversions from academic studies is offered in Annex III.

14. **A study by Statistics Netherlands defined corporate inversions with new home countries in the Netherlands** as those that (i) were born and undertook their initial growth stages abroad and (ii) had a relatively limited share of their global activities in the Netherlands (Nelisse and Hiemstra (2019)).

15. **An additional question reflects the relation between corporate inversion statistics and direct investment statistics by ultimate investing economy, which would become tighter if both sets of statistics followed a similar control approach (“winner takes all”) based on the concept of the ultimate controlling institutional unit.**[5] Regarding the question of subsequent acquisitions by the new foreign parent of an inverted corporation, it might be considered that once a *false* foreign parent is identified, all of its subsequent acquisitions in the economy of the inverted corporation are inversion-related. To consider the data confidentiality constraints, statistics on inversions could be presented in less-detail, such as positions only, and/or with less frequency. Under this alternative,

[5] This links with the DITT guidance note on D.6 Ultimate Investing Economy/Ultimate Host Economy and Pass-through Funds, which considers options on how ultimate statistics could be compiled. Corporate inversions may complicate those methods.

countries that are home or host to a significant amount of inversion-related direct investment, are encouraged to publish some statistics for these investments separately.

III. Alternative 3 (A3)

16. **To record corporate inversions as portfolio, rather than direct investment.** Although not strictly a condition for direct investment, because the new foreign parent does not tend to "supply additional contributions such as know-how, technology, management, and marketing" (*BPM6*, paragraph 6.4), corporate inversions (and other transactions primarily motivated by financial engineering) should be recorded as portfolio, rather than direct investment. Ideally, in cases where the new foreign parent does not have a significant presence, one might question whether it is even a separate institutional unit (similar to SPEs, near-SPEs, etc.) and, therefore, whether an international transaction has even occurred. Practically speaking, however, these events often involve large transactions in the portfolio accounts, as domestic shareholders in the inverting company receive shares in the new foreign parent company and the new foreign parent company takes a financial position in the inverting company. Therefore, this treatment would lead to largely offsetting portfolio investment flows as the flows that would have been recorded as DI under current guidelines are recorded as portfolio investment.

SECTION II: OUTCOMES

17. **Discussion within the Direct Investment Task Team (DITT) support alternative A2.** As things stand, corporate inversions reduce the analytical usefulness of direct investment statistics because they are motivated by factors other than those conventionally ascribed to direct investors (*BPM6*, paragraph 6.4). The practical challenges of identifying corporate inversions are duly noted. If alternative A2 is adopted, there will need to be a standard definition of a corporate inversion to guide compilers.

18. **This note proposes the definition as mentioned in paragraph 8.19 of the *BPM6*, that is "A corporate inversion describes the corporate restructuring of a transnational enterprise group such that the original parent company in one economy becomes a subsidiary of the new parent in another economy. In addition, ownership of a group of enterprises may be shifted to the new parent company."** Additional guidance can be found in the remainder of paragraphs 8.19–8.22 of the *BPM6* (reproduced in Annex 4) and in the academic literature. Cortes, Gomes, and Gopalan (2015), for example, explore the question of corporate inversion in some detail (see Annex III for a summary of their definition). There will also need to be discussions over how to treat subsequent acquisitions of domestic companies by the new foreign parent, as discussed in paragraph nine.[6]

19. **On a practical aspect, the DITT recognizes that developing this additional guidance will require effort and that, no matter how carefully it is done, identifying inversions may still require a high degree of expert judgement from compilers.** The DITT also recognizes the data confidentiality challenges of publishing data for corporate inversions due to the large and infrequent nature of these

[6] Professional judgment from compilers might be needed to assess whether reallocation of operational headquarters or operations of a purely administrative nature involving only the change of International Securities Identification Number (with the corresponding change in the geographical identification) fall under the definition of corporate inversion.

transactions but believe these challenges can be managed by publishing data at higher levels of geographic aggregation and/or less frequent intervals. For instance, annual data on direct and portfolio investment positions of inverted companies and on their primary income balance might be useful to assess the effects of inversions on home and host countries. Also, because of the asymmetric treatment of reinvested earnings under portfolio and direct investment, it could be useful to publish information on retained earnings of the new parent companies. As in the *BPM6*, these presentations would remain supplemental and at the discretion of the reporting economy based on the significance of corporate inversions in their direct investment statistics and availability of information on corporate structures and operations.

REJECTED ALTERNATIVES

16. **Alternative A1** was rejected because we believe that additional guidance is needed on identifying inversions and on the types of statistics that could be useful to policymakers and analysts.

17. **Alternative A3** was rejected because the practical solution offered does not address the conceptual question of whether an international transaction should even be considered to have occurred, and the practical solution offered would be difficult to implement because both sides of the transaction typically would not be covered by portfolio investment statistics.

Questions for Discussion:

1. *Does the Committee feel that corporate inversions have degraded the analytical usefulness of direct investment statistics, and key national accounting aggregates like corporate profits and gross national income?*
2. *Does the Committee agree that an official definition of corporate inversion, for example, for statistical or fiscal purposes is needed?*
3. *Does the Committee agree with the definition proposed in paragraph 18?*
4. *Does the Committee agree that countries for which this is an important phenomenon and with a clear definition to guide compilers, should produce supplemental statistics on corporate inversions?*

Annex I. Supplementary Information

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In addition to these articles, Ireland’s CSO regularly publishes statistics on redomiciled corporations. See, for example, “Redomiciled PLCs in 2019” (https://www.cso.ie/en/releasesandpublications/ep/p-ia/internationalaccountsq12020final/redomiciledplcs2019/).

Annex II. Excerpt from Hanson et al. (2015)

INVERSIONS AND BEA'S NATIONAL STATISTICS

"The effect of inversions on outward and inward direct investment statistics are reflected in select aggregates of the national income and product accounts (NIPAs), most notably, the income receipts from, and payments to, the rest of the world and the NIPA aggregates that include these data in their derivation—corporate profits and gross national income. […] Generally, inversions would reduce gross national income, that is, income resulting from the current production of goods and services by U.S.-owned labor and capital. Corporate profits, the portion of the total gross national income earned from current production that is accounted for by U.S. corporations, would also be reduced by a decrease in net profit receipts from the rest of the world (profit receipts from the rest of the world less profit payments to the rest of the world). The introduction of a new foreign owner generates a payment to the rest of the world in the form of direct investment income on equity that includes the worldwide profits of the inverting corporation. However, this payment may be offset to some extent by a receipt from the rest of the world in the form of dividends that are paid by the new foreign corporation to its U.S. shareholders, some of whom may be former shareholders in the U.S. corporation that inverted. Given that corporations rarely pay dividends equal to, or more than, their total current earnings, the inversion's effect on profit payments to the rest of the world would typically be greater than its effect on profit receipts from the rest of the world, and *therefore the effect on net profit receipts from rest of the world would be negative*."

This issue is being discussed separately under the Financial and Payments Systems Task Team guidance note F.2.

Annex III. Characteristics of Inverted Corporations from Selected Academic Studies

	New parent company				Old parent company	
	Foreign economy	Foreign economy with lower tax rate	Listed on the stock exchange of old parent company's home economy	Follows securities laws of old parent company's home economy	Retains management and control functions of the global corporation	Location of the majority of the firm's shareholders
Cortes, Gomes, Gopalan (2014)	x	x	x	x		x
Rao (2015)	x	x				
Webber (2011)	x	x			x	
Voget (2011)	x					x

Cortes, Felipe, Armando Gomes, and Redhakrishnan Gopalan. "Corporate inversions and Americanizations: A case of having the cake and eating it too." Available at SSRN 2481345 (2014).

Rao, Nirupama. "Corporate inversions and economic performance." NYU Wagner Research Paper 2566429 (2015).

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Annex 4. *BPM6* Guidance on Corporate Inversions

8.19 Corporate inversion describes the corporate restructuring of a transnational enterprise group such that the original parent company in one economy becomes a subsidiary of the new parent in another economy. In addition, ownership of a group of enterprises may be shifted to the new parent company. Such arrangements may be called corporate relocations, headquarters relocations, or corporate restructuring. The process may take place over more than one period. Although corporate inversion has a similar economic effect to a change of residence of the parent company (as discussed in paragraphs 4.167 and 9.21), it differs in that inversion is achieved by transactions in assets between different entities, rather than by a single entity changing its residence. So, corporate inversion results in financial transactions being recorded in the financial account. However, some other types of restructuring may involve other changes in volume, for example, the appearance or disappearance of entities.

8.20 While the economy of the direct investor is changed by corporate inversion, the operational structure and ultimate shareholders remain effectively unchanged, but the new parent company has the benefit of the taxation and regulatory environment of its economy of incorporation. Because inversions can involve large values in the financial account but with little or no movement in resources, there may be analytical interest in separating them from other direct investment. If not prevented by confidentiality, supplementary data could be provided.

8.21 In these cases, the assets of the original parent company are treated as having been returned to the shareholders of the parent company through the withdrawal of equity and then as being reinvested in the new parent company at the same value. That is, there is a rearrangement of balance sheets through transactions in equity in the financial account of equal value with no change in net lending or borrowing. (These entries may include both portfolio and direct investment.) With some forms of restructuring, the direct investment enterprises of the old parent may become the direct investment enterprises of the new one.

8.22 As noted, assets may be shifted from one enterprise to a second enterprise because of restructuring within an enterprise group. As with other stock swaps, the owners are selling securities in the first enterprise and buying securities in the second enterprise. (These are financial account entries, not capital transfers or other changes.)