The October 15 decision by AbbVie Inc.'s board of directors to reverse its previous recommendation that shareholders back a proposed merger with Shire PLC reflects the uncertainty around the costs of doing inversions under coming guidance from the Treasury Department.

In a statement, the board said it decided to withdraw its recommendation after considering the impact that the IRS's recent anti-inversion notice will have on U.S. tax rules. (Notice 2014-52, 2014-42 IRB 712. Prior coverage. Related analysis. Shire response.)

"The breadth and scope of the changes, including the unexpected nature of the exercise of administrative authority to impact longstanding tax principles, and to target specifically a subset of companies that would be treated differently than either other inverted companies or foreign domiciled entities, introduced an unacceptable level of uncertainty to the transaction," the board said.

The board said the coming changes would also eliminate some of the transaction's expected financial benefits, most notably the ability to access current and future global cash flows in a tax-efficient manner. "This fundamentally changed the implied value of Shire to AbbVie in a significant manner," the board said.

Under the terms of the parties' cooperation agreement, AbbVie will have to pay Shire a "break-up" fee...
of $1.635 billion if AbbVie's shareholders do not approve the adoption of the merger agreement at a shareholder meeting, or if that meeting does not occur by December 14.

While it's too soon to say whether Notice 2014-52 is curbing multinationals' appetite for inversions, practitioners say it's at least giving them pause. "The notice is having its intended effect by forcing companies to think twice about moving forward with an inversion deal," said Jorge Castro, a former senior IRS official who now runs tax consulting firm Castro Strategies LLC.

"Companies are doing a thorough cost-benefit analysis for moving forward with an inversion, carefully weighing the business and tax benefits post-notice," Castro said. They may also be considering the political element and potential public relations fallout, he said.

"There are more companies with pending inversion deals, so their next steps will be interesting to follow in the coming weeks," Castro said.

AbbVie's about-face may indicate that the deal became too expensive when weighing the impact of the coming rules, said Carol P. Tello of Sutherland Asbill & Brennan LLP.

"The people who drafted the notice had hoped it would have this kind of effect, and now it looks like it is, at least in some cases," said Patrick J. Smith of Ivins, Phillips & Barker. "I'm sure this news was met with a lot of satisfaction at Treasury."

Douglas S. Stransky of Sullivan & Worcester said that because tax is just one of many factors that companies consider when contemplating inversions, AbbVie may not signal a trend in collapsed deals. "But companies will look hard at whether the math will work for them," he said. "More important, they will look hard at what other unilateral actions the U.S. government might take to stop a transaction it does not like because of some perceived abuse. It's that uncertainty that's likely to stop more transactions."

Attributing the AbbVie board's reversal to Notice 2014-52 may be overreading its reach, said Bret Wells of the University of Houston Law Center. "A better explanation may be that companies are more concerned about recent statements that the earning stripping aspects of inversions may be dealt with in forthcoming guidance and that that guidance may impact inversions that have not closed," he said. "Given the uncertainty on the existence of the tax benefits from those earning stripping transactions, the implied premiums for these deals may be impacted."

Wells said the anxiety over inversion rules is nothing new. "When the law is in flux, the inversion wave subsides," he said. "But, if the financial benefits for being a foreign-based multinational remain and the rules become clear, then the impetus to find new forms of compliant inversions will again take center stage."

Until the government addresses the earnings stripping advantages that foreign-based multinationals have when reducing U.S. taxation of their U.S. business activities, the financial incentives for inversions will remain compelling, Wells said.

"But, much like in earlier periods of inversion guidance, companies and practitioners may want to have clearly defined rules before engaging in inversions, so the current uncertain state of the law may have some temporary impact," Wells said.

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