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Tax Dodge Used by Bain Shifts U.S. Firms Abroad Without Scrutiny

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Bloomberg News

One proposed rule change that may affect such buyouts was crafted by Democratic lawmakers including Representative Sander Levin of Michigan, echoing a proposal from the Treasury Department. Photographer: Andrew Harrer/Bloomberg

August 25, 2014 – There's more than one way for a U.S. company to avoid taxes by claiming a foreign address.

Consider the business founded in 1916 as General Plate Co., a maker of sensors and controls for everything from Fords and Frigidaires to the spaceship that first carried Americans to the moon. While its top executives are still based in Attleboro, Massachusetts, it's now known as Sensata Technologies Holding NV of the Netherlands.

Sensata didn't become Dutch by using the strategy known as "inversion" that has alarmed President Barack Obama and that the U.S. Treasury Department and some Democrats in Congress are trying to curb. That technique, which involves reincorporating overseas without a change in majority ownership, has helped more than 40 U.S. companies lower their tax bills.

Instead, Sensata is one of at least 13 firms that have left the U.S. tax system through a sale to an investment fund, according to a tally by Bloomberg News. Although these companies have a combined market value of about $75 billion, this tax- avoidance strategy has gotten less attention in Washington than inversions and may be harder to discourage.

These buyouts mean profits for the U.S. private equity firms like Boston-based Bain Capital LLC that orchestrated them. Bain earned more than $3 billion after it took Sensata public as a Dutch company in 2010, with an effective tax rate about one- tenth of some competing manufacturers.

Minimize Taxes

Shifting to a foreign tax domicile "is looked at hard in every private equity deal," said Joan Arnold, a tax partner at Pepper Hamilton LLP in Philadelphia. "They will be interested in what they can do to minimize taxes, and maximize sale price."

Sensata and Bain declined to comment.

For the past three decades, Congress and regulators have adopted rule after rule to limit inversions, and a fresh wave of such deals has prompted discussions about tightening the law again. The Treasury Department is also studying how it can attack inversions without congressional action.

The buyout deals promise to be trickier to regulate, because they involve U.S. companies that are technically sold to a foreign acquirer – typically a shell company set up by the buyout fund in a tax-friendly jurisdiction like Bermuda. Policymakers are loath to penalize takeovers by genuinely foreign acquirers. A 2004 law targeting inversions didn't address the technique at all.

'Corporate Deserters'

Remarking that inverted companies have been called "corporate deserters," President Obama has accused them of exploiting "an unpatriotic tax loophole." The 51 companies that have inverted since 1982 or plan to do so have a current market value of $689 billion, based on the Bloomberg News tally. The total doesn't include Burger King Worldwide Inc., the U.S. burger chain that said yesterday it's in talks to buy Tim Hortons Inc. and move its headquarters to Canada from Miami.

By one Congressional estimate, future inversions will cost the Treasury Department $19.5 billion in forgone revenue over the next decade. It's unclear how much the buyouts cost the U.S. government, or whether their impact is included in the estimate.

Companies that have gone offshore with the help of an investment fund include Michael Kors Holdings Ltd., the New York handbag maker that's now incorporated in the British Virgin Islands; and Herbalife Ltd., the nutritional and weight-loss supplement company run from Los Angeles and incorporated in the Cayman Islands.

Kors declined to comment. Hilary Rosen, a spokeswoman for Herbalife, said the Cayman Islands incorporation wasn't chosen for tax purposes.

Dell Buyout

As part of its $24 billion buyout by founder Michael Dell last year, the Round Rock, Texas-based computer maker Dell Inc. evaluated the idea of reincorporating in a foreign country. A description of the tax move was included in a presentation to the company by its bankers at JPMorgan Chase & Co. that was filed with the Securities and Exchange Commission.

The plan might have helped Dell make use of billions of dollars in profits that it had accumulated in foreign subsidiaries and that hadn't yet been taxed in the U.S., according to the presentation.

One downside, according to the presentation, was that it risked alienating one of Dell's biggest customers, the U.S. government. The company opted to remain registered in the U.S. It declined to comment.

Bain, which was co-founded by former Republican presidential candidate Mitt Romney and counts Boston Celtics co- owner Stephen Pagliuca among its top executives, followed up its Sensata acquisition by getting a Luxembourg domicile for a plastics maker run from Pennsylvania. Other private equity firms that have helped companies expatriate are New York-based Blackstone Group LP and TPG Capital of Fort Worth, Texas. The firms all declined to comment.

Private Deals

There may be more such buyouts than is publicly known. Companies sold to private-equity firms often stop making disclosures to the SEC until they seek to return to the public markets years later. So there's no way of knowing how many buyout firms used the technique in recent years, a time when the pace of inversions by publicly traded companies surged.

"One thing about private equity is that it's private," said Arnold, the Pepper Hamilton lawyer.

One proposed rule change that may affect such buyouts was crafted by Democratic lawmakers including Representative Sander Levin of Michigan, echoing a proposal from the Treasury Department. That rule would treat certain companies as domestic taxpayers after a sale to a foreign buyer if the combined company's "management and control" remain in the U.S.

'Double Whammy'

Depending on how the language is interpreted, that might affect companies that undergo future buyouts like Sensata's. Of the 13 buyout deals since 1990 in the Bloomberg tally, all but three of the companies kept their top officers in the U.S.

Even if the language applies, however, it may just create another potential problem: Companies might move their top executives abroad as part of a leveraged buyout, taking high- paying jobs as well as tax revenue out of the country.

"You'd have a double whammy," said Nancy McLernon, the head of the Washington-based Organization for International Investment, which represents foreign-based companies operating in the U.S. "Only in Washington would we applaud a proposal that would encourage management to leave the U.S."

In some cases, Arnold said, such a law would lead private- equity bidders to tell a company's managers, "We're going to do this deal, but the day after, you're all moving to Ireland."

Republican lawmakers are mostly opposed to legislation to tackle inversions unless it's part of a broader revamp of the tax code, arguing that the U.S. tax system should be made less onerous so that companies aren't compelled to flee. Even some Democrats have criticized the "management and control" idea.

Unintended Consequences

Senator Charles Schumer, the New York Democrat, said at a hearing in Washington last month that he's concerned the "management and control" clause might have unintended consequences. He's working on his own bill targeting inversions and hasn't made it public yet.

Mark Mazur, the assistant Treasury secretary for tax policy, said in a statement to Bloomberg News that "the administration's proposal is designed to ensure that firms with substantial U.S. business operations and executives in the United States also pay their corporate income taxes here, rather than changing their tax residency by simply using creative tax techniques."

Sold to Bain

Sensata got its start almost a century ago as a supplier of gold plating to the jewelry industry in nearby Rhode Island. Sold to Dallas-based Texas Instruments in 1959, it became the electronics company's materials and controls

Bain Capital LLC, which was co-founded by former Republican presidential candidate Mitt Romney and counts Boston Celtics co-owner Stephen Pagliuca among its top executives, followed up its Sensata acquisition by getting a Luxembourg domicile for a plastics maker run from Pennsylvania. Photographer: Scott Eells/Bloomberg

division. The unit supplied controls used on the Apollo 11 moon mission, and provided expertise for a restoration of the Statue of Liberty's copper skin in the 1980s. Much of its sales come from sensors used in automobiles.

By 2006, when Texas Instruments christened the unit Sensata and sold it to Bain for $3 billion, most of its manufacturing operations had already been shifted to lower-cost countries like Mexico, China, and Malaysia. Only 18 percent of its 5,550 workers were based in the U.S.

The buyout firm completed the acquisition through a Dutch entity, using a company factory near the German border as its legal address. Thomas Wroe, who became chief executive officer, remained in Attleboro along with most of his top managers.

When Bain sold shares to the public in 2010, Wroe and his staff included the company's favorable tax rate as part of their sales pitch. On a conference call, Wroe said that Sensata paid cash taxes of about 4 percent of its "adjusted net income," which he said compared with 30 to 40 percent rates paid by some competitors.

'Big Benefit'

Part of the reason for the rate is Sensata's Dutch domicile, which allows it to earn profits in subsidiaries around the world without subjecting them to taxes in its home country. American companies, by contrast, must pay U.S. taxes on foreign earnings before they make use of the funds. The U.S. corporate tax rate, of 35 percent, is the highest in the developed world.

During a presentation that year, Chief Financial Officer Jeffrey Cote said the Dutch domicile "is a big benefit" that the company will enjoy "forever."

Bain has now sold most of its shares in Sensata to the public, pocketing about five times its original $880 million investment, according to calculations based on Sensata's SEC filings.

Last year, Wroe's successor as CEO, Martha Sullivan, spoke at an investing conference in Laguna Beach, California. Given the growing political scrutiny of "offshore tax vehicles," a Morgan Stanley analyst asked, was Sullivan concerned about the Dutch domicile?

"I don't see it as a near-term risk or even an intermediate-term risk," Sullivan replied, adding that the company's effective rate would probably ultimately rise to the "high teens or low 20s" when some unrelated short-term tax benefits from the buyout transaction expire.

"We don't think that kind of a tax rate is one we would need to apologize for," she said. "You could turn around and say, how does this country then become more friendly from a business perspective?"

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