Case Study:

Growth and Liquidity through Cross-Border "Corporate Flip" (Inversion)

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The Challenge

What do you do to generate new markets and new funding when you are a promising non-U.S. company? Think about converting to a U.S. business with foreign subsidiaries…

The Solution

This case study analyzes key business, legal and tax issues in a restructuring and "inbound" corporate "inversion" to the United States. The inversion and related restructuring helped a foreign technology company find new markets, a new sales team and new equity funding.

An "inversion" (often called a "flip") occurs when a company changes its corporate domicile by reincorporation or merger into another company into another taxing jurisdiction. An inversion changes the tax nexus of the top-level legal entity in a group from one country to another. Sometimes the change of tax nexus is done through a "spinoff" followed by an inversion, or "spinversion," where there is a combination of a foreign spinoff and re-location of corporate headquarters for the spun-off subsidiaries but no merger or acquisition.

Our Role - Planning, Structuring and Coordination of Implementation

Bierce & Kenerson advised on, structured and documented the transactions necessary to accomplish the scope of the project. We identified and defined the sequencing of related foreign and U.S. transactions. We provided counsel on corporate, financial, employment, U.S. tax and intellectual property issues. The professional team included a foreign law firm and Bierce & Kenerson, P.C.

Background

Foreign Technology Company Operations. In "Year 1," a European individual established a European web-based tech services company to provide B2C and B2B support for commercial transactions in the retail sector for consumer goods and services. Two local European venture capital funds invested substantial seed capital in the foreign startup. Software development was conducted locally in the home country and in an Eastern European country.

U.S. Operations. In the spring of "Year 5,", we incorporated the company in the U.S. to serve as its U.S. operating company ("US Co"). Two Americans, who had lived abroad and been active in marketing, product design and sales, moved back to the U.S. to assume responsibilities for marketing to U.S. customers.

Founder's Personal Strategy. The founder wanted to move on to another business focus after concluding he had established a viable operation. Taking a strategic view, the founder decided to reduce his majority ownership and to cede control to new management in a partial cash-out scenario. However, he wanted to retain substantial control while pursuing new business options.

Situation/ Scope

Unfinished "Housekeeping. The foreign company had "unfinished business" that needed corporate housekeeping. When he obtained European VC funding in the Series A round, he committed to avoid dilution of the VC's when allocating shares to the "sweat-equity" pool. As the founder grew the company, he had more "sweat-equity" workers seeking stock in exchange for services. Under foreign law, there was no special advantage to a "qualified incentive stock option" plan (such as one in the U.S.), so he delayed transferring shares to the other sweat equity workers until he was ready to cede majority control and obtain some cash in exchange.

Impediments to Growth in Home Markets. In addition to seeking a partial exit and transfer of substantial operating responsibilities to others, the founder knew the operation needed further capital. Current VC investors in the company were unreceptive to contributing additional capital. So he and the American managers went in search of new funding in the U.S. They found substantial new re-seed money. However, the new American investors did not want to invest in a foreign company and the foreign investors were willing to allow the foreign company to "Americanize" its funding and operations.

Approach

Project Management. Together with a foreign law firm that represented the foreign startup, Bierce & Kenerson, PC designed a strategy and prepared a checklist of documents required under both foreign and U.S. laws. To visually define the relationships, we diagramed all existing and future relationships in an organization chart for review and comments, so we were all literally on the same page. To sequentially define the project's phases, we prepared a Memorandum of Understanding for the parties to establish the purpose, scope, sequence and content of the legal documents.

Relationship Management. To exchange ideas freely, we worked with the foreign law firm in both English and French, including our markup in French of certain corporate documents. We used video telecommunications.

E-Tools for a Multinational Closing / Completion. The parties and signatories resided in five countries. The documentation was done in English, except for the share transfers under foreign law. The signatures on the closing documents were done manually in the foreign capital and electronically in four countries using an electronic online tool for "e-signatures" valid under the foreign statutes. The online tool was designed to meet European security and privacy standards, so execution was done faster than overnight document courier and more cheaply than having a physical closing.

Strategies. As part of a plan to attract new capital from American investors, the foreign technology company's shareholders agreed to exchange their shares for the shares of US Co. Immediately before this exchange, the founder transferred a portion of his own shares to the new American investors and the sweat equity workers. As a result of this exchange, the foreign technology company became a subsidiary of the US Co. It "flipped."

The heart of the strategy was to identify differences that would justify low-tax or tax-free treatment for different parties.

- *Different Dual Valuation Principles for Different Classes of Taxpayers.* To accommodate different tax profiles of the parties, we developed a two-tiered valuation strategy. The sale to the sweat equity workers would be at a lower price based on special restrictions and structuring. This would justify a lower valuation than the valuation for the new investors.

- *Structural Differences in Value between a European Corporation and a U.S. Corporation.* While the foreign technology company had developed a Web-based business management tool, it required significant further development and additional sales efforts to realize its potential. Purely due to the changes in place of incorporation and place of business, the same technology will have potentially greater fair market value in the United States than in its home country. The two countries have different market sizes, different market opportunities and different regulatory and tax regimes that promote or inhibit the possibilities for market success of new Web-based services. Consequently, investors may argue (for tax purposes) that there is no connection between the price paid by the key individuals for the shares of the foreign entity and the price paid by new capital contributors to a promising new U.S. entity driven by the enthusiasm of its new key managers located in the United States.

- *Partial Exit, Partial Succession Plan by Management of Foreign Company.* In this transition, the founder accomplished his objectives of retaining partial control of US Co and relinquishing management of day to day operations to a new team.

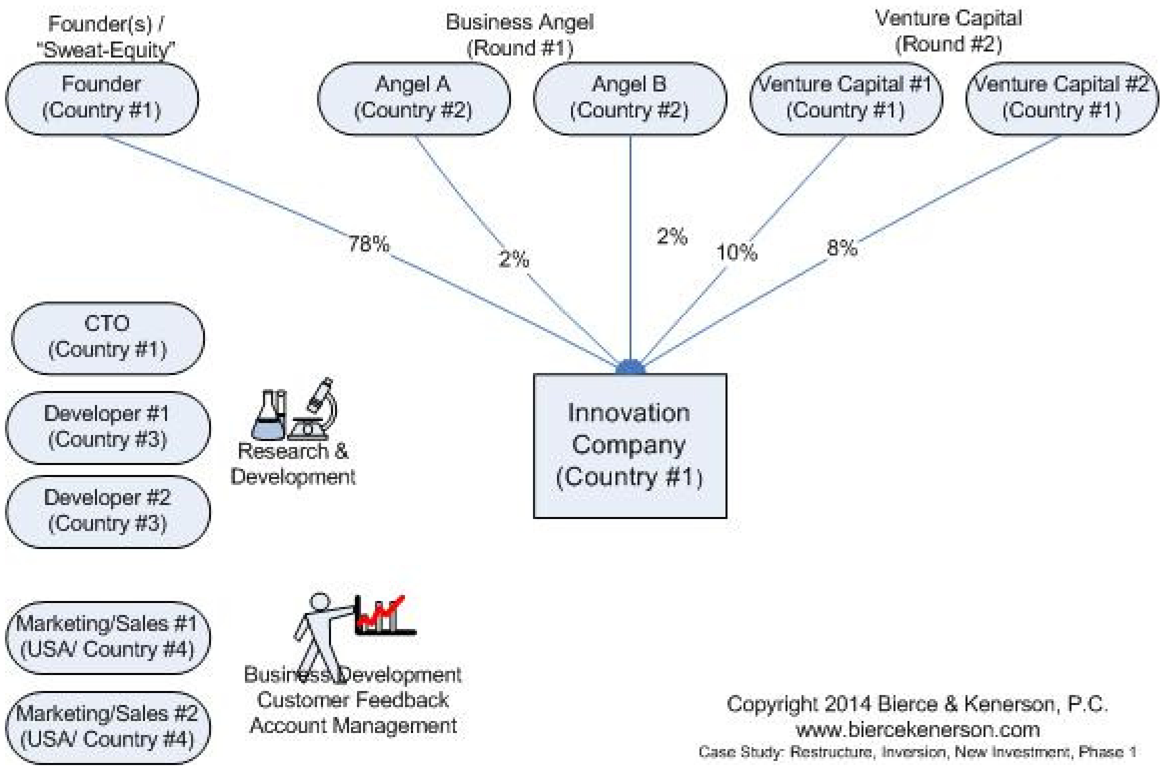
We timed these transactions to coincide so that the "control" requirements for tax-free restructuring would be satisfied.

Outcome

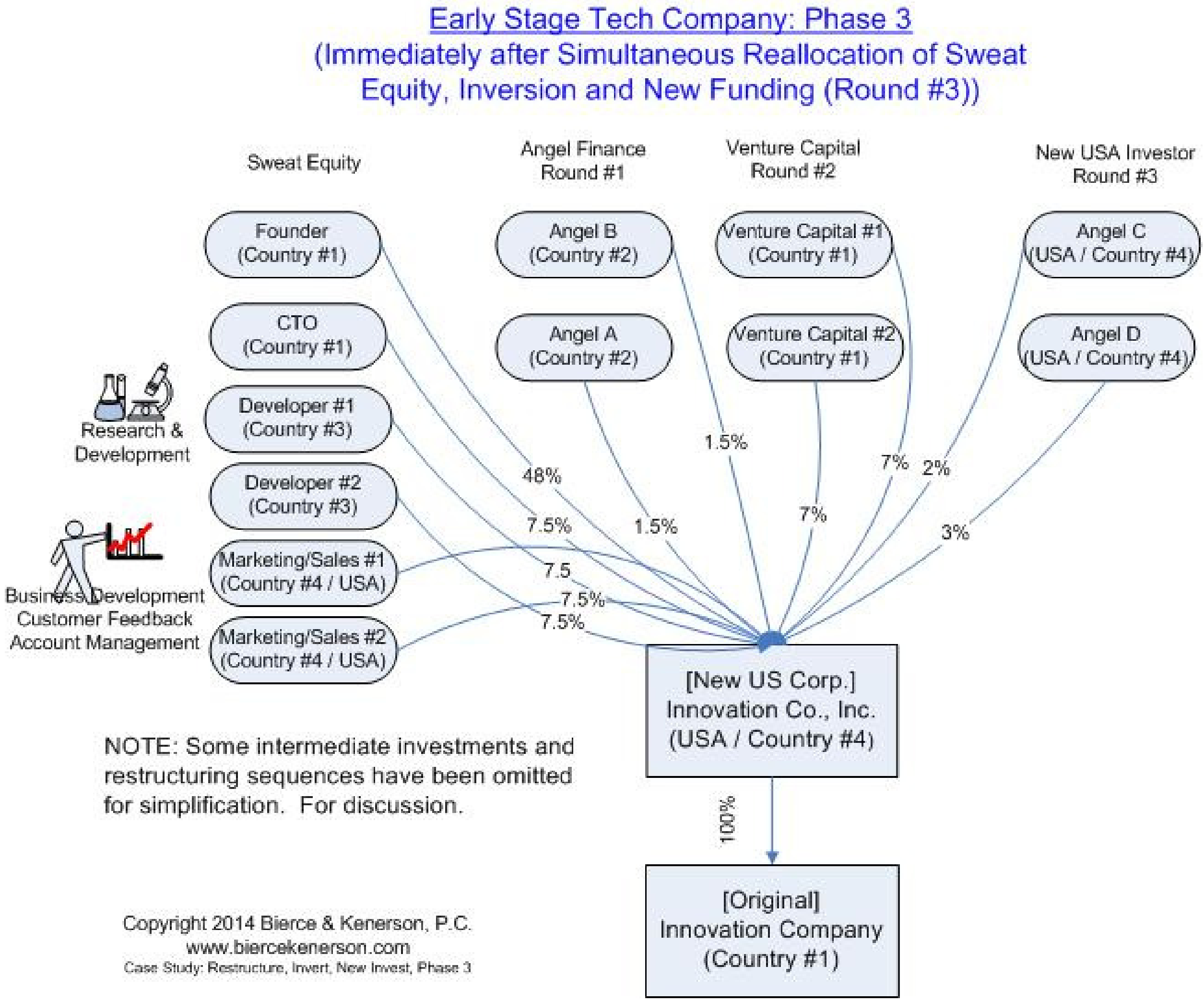
The enterprise recovered lost momentum through new management (though the founder retains the role of President) and new capital in a separate entity, not the French entity. The business found new markets and retained the foreign development team, who will share in the future growth. Further, the multi-nationality of the growth company after the inversion will enable the integrated business to build upon foreign technology while also growing through sales to U.S. clients and customers.

ORGANIZATIONAL DIAGRAM #1: BEFORE RESTRUCTURING, INVERSION AND NEW INVESTMENT

Early Stage Tech Company: Phase 2
(Immediately after Angel Finance (Round #1) and Venture Capital (Round #2))



ORGANIZATIONAL DIAGRAM #2:
AFTER RESTRUCTURING, INVERSION AND NEW INVESTMENT



Case Study: Restructure, Invert, New Invest, Phase 3