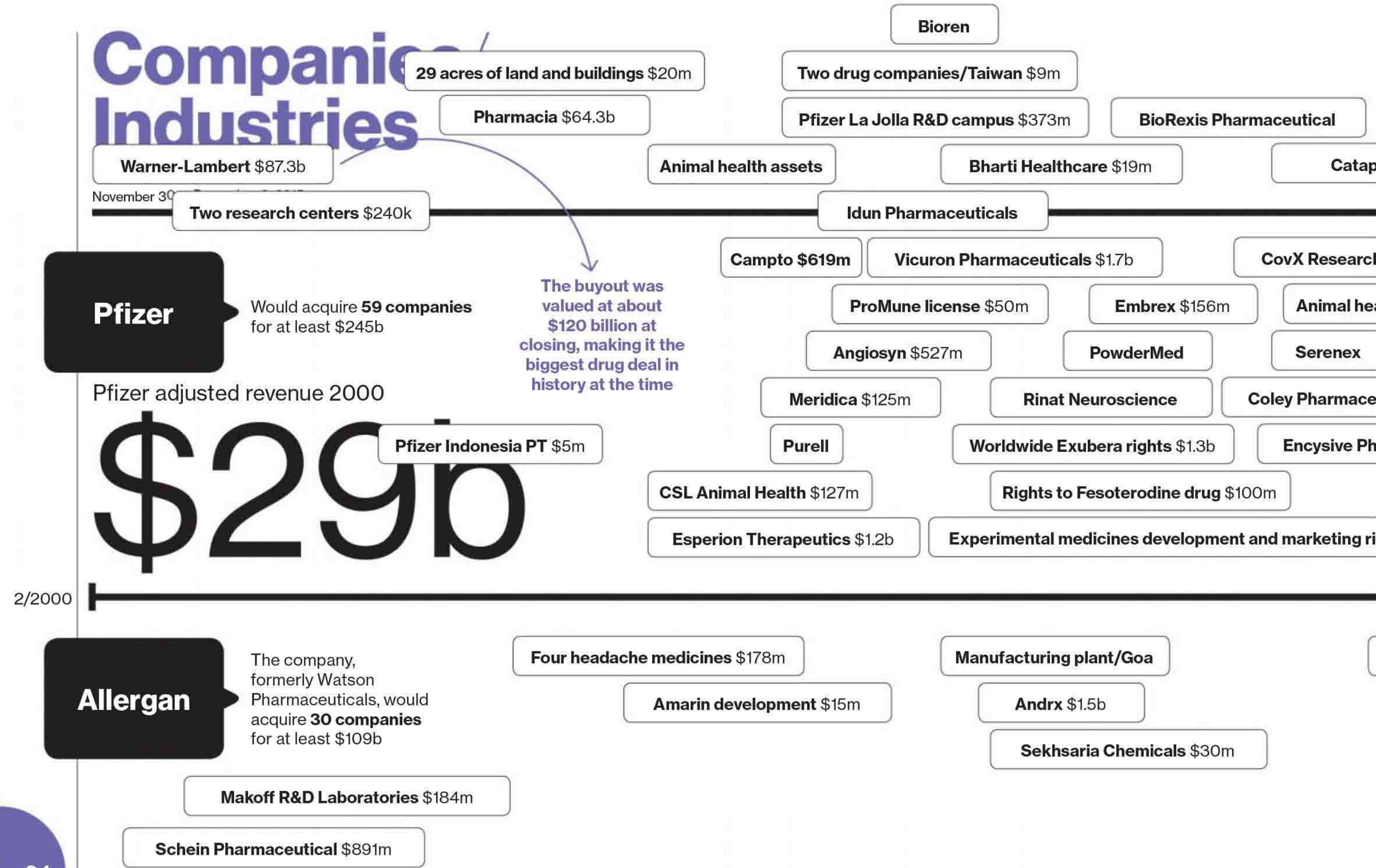

Pfizer's $160 Billion Change

▶ **Its deal with Allergan, the biggest drug merger ever, is all about finding a cheaper tax home**

▶ **Drugmakers may "set aside...loyalty to America for their more immediate loyalty to shareholders"**

Pharmaceutical companies are always preoccupied with such issues as the number of new drugs in their research pipelines or the legal protections for their patented medicines in the developing world. But lately, many have been consumed with a different concern: taxes. Just how acutely became apparent on Nov. 23, when **Pfizer** and **Allergan** agreed to combine in a record $160 billion deal, creating a drugmaking behemoth to be called Pfizer Plc that will sell products from Viagra to Botox.

The transaction is a complicated legal maneuver that technically lets Dublin-based Allergan buy its much larger New York-based partner. That will make it easier for the combined company to locate its tax address in Ireland, where corporate income is taxed at less than half the U.S. rate. If the new entity is able to establish itself abroad for a lower tax rate, a controversial process called an inversion, it will be the largest such move in history.

Pfizer expects to pay about a 25 percent adjusted tax rate companywide in 2015, which it says would drop to about 17 percent the first full year after the Allergan deal closes. Still, the drugmaker's operating headquarters will be in New York, and Pfizer Chief Executive Officer Ian Read will be CEO of the new company. Allergan, formerly known as Actavis, made its own move to Ireland in 2013.

"The lure of tax advantages from a Dublin head office has been a significant factor in driving this deal," says John Colley, a professor at England's Warwick Business School who studies large-scale mergers. "The threat of succumbing to U.S. tax rates has meant that Pfizer has been desperate for a deal outside the U.S."

The number of similar attempts to escape Uncle Sam's tax bite has been growing for a decade, and Congress hasn't been particularly aggressive about slowing the flight. But the sheer size of the Pfizer deal—and the prospect that other U.S.-based drug companies may feel pressure to follow suit—could turn up the heat on lawmakers who haven't been eager to remove the tax avoidance technique from the back burner. Together, barring any divestitures, the conjoined Pfizer Plc will be the world's biggest pharmaceutical company by annual sales, which will be about $60 billion. It will also be the largest acquisition ever in the pharma

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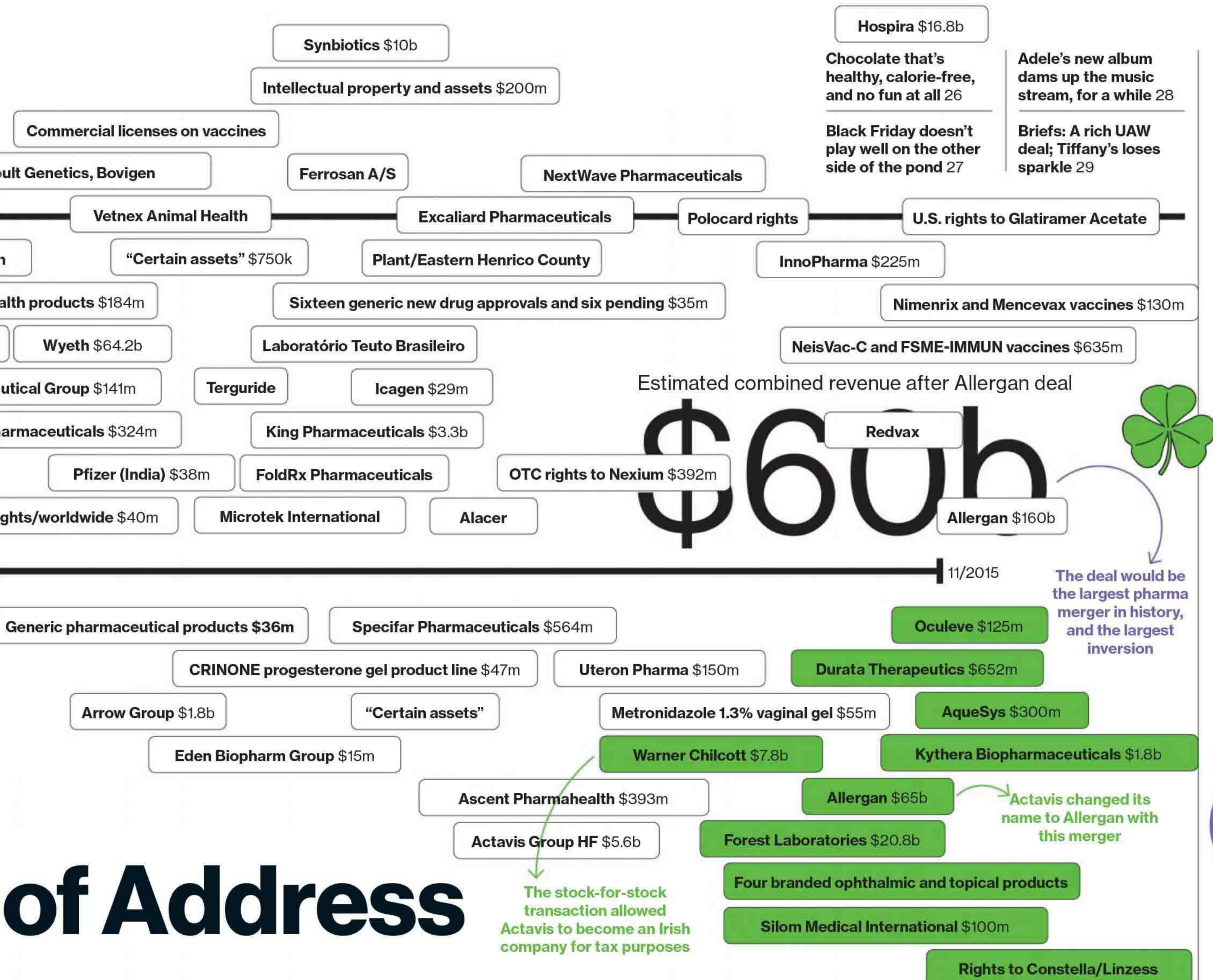

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world, eclipsing Pfizer's roughly $120 billion purchase of Warner-Lambert in 2000.

The U.S. Department of the Treasury has increasingly targeted inversions, most recently in November, when it announced it's reducing the tax benefits of inversions by limiting the ability of an inverted company to transfer its foreign operations to the new foreign parent without paying U.S. tax. At 35 percent, the U.S. tax rate for businesses is the highest in the world, and it's one of the only countries to tax the profits of its corporations wherever they're earned. Ireland's corporate rate is 12.5 percent. The U.S. Treasury has derailed other proposed inversions, including **AbbVie**'s plan to buy Ireland's **Shire** for an estimated $52 billion in 2014. But analysts say that by listing Ireland-based Allergan as the purchaser, the Pfizer-Allergan deal appears structured to avoid U.S. tax inversion rules.

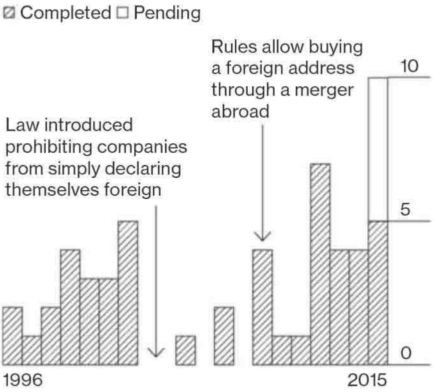
Read, who has long said that having the company's tax domicile in the U.S. puts it at a competitive disadvantage, reached out to congressional leaders and the White House after the deal was sealed. His pitch: The merger will help the company invest in more innovative drugs, and it will have 40,000 employees in the U.S.

Some top Republicans say inversions are a consequence of high corporate taxes, but Democrats disagree. White House Press Secretary Josh Earnest wouldn't comment directly on the Pfizer deal, but he repeated President Obama's "long-standing concern and outright criticism of companies to pursue this strategy," which amounts to their renouncing their citizenship "while continuing to benefit from all America has to offer."

Democratic presidential front-runner Hillary Clinton went further, saying Pfizer's plan to move its tax address to Ireland would harm U.S. taxpayers. "This proposed merger, and so-called inversions by other companies, will leave U.S. taxpayers holding the bag," she said in a statement. "As president, I will fight to reform our tax system to reward growth, innovation, and job creation here in the United States. We cannot delay in cracking down on inversions that erode our tax base."

The betrothed companies are no strangers to making deals to better their results. Pfizer has made almost 60 acquisitions since 1999, including its $17 billion purchase this year of Hospira, the maker of generic drugs usually administered in hospitals. New Jersey-based Actavis did about 30 deals over the same period before completing a $66 billion purchase of drugmaker Allergan in March; it then took on the company's name. The operational ▶

U.S. Corporate Inversions



◀ headquarters and top executives remain in New Jersey.

Pfizer already employs about 3,200 people in Ireland, where it makes an ingredient used in Viagra. It says it's invested $7 billion there since 1969. Allergan produces Botox there and employs more than 1,000 people. In all, 140,000 people are directly employed by more than 700 U.S. companies in Ireland, according to the American Chamber of Commerce Ireland.

While Irish Minister for Finance Michael Noonan recently said Allergan and Pfizer were plainly merging for "tax advantages," the government has no problem with the deal because both companies had "substantial" operations in Ireland. "We are not pushing for inversions," says Noonan. The agency charged with winning investment for Ireland "never promotes inversions. It's a decision for the two companies."

Although analysts are waiting to see whether other cash-rich drug companies follow Pfizer's lead, it's not that simple. To qualify as an inversion in the eyes of the Treasury, and reap the tax benefit it brings, a company needs to meld with a foreign entity that's at least 25 percent its size. That means the huge companies that would benefit most from the technique have to snag one of a handful of very big foreign pharma companies.

Bayer, **GlaxoSmithKline**, **Novartis**, **Roche Holding**, and **Sanofi**, the only non-U.S. pharma companies near or above $100 billion in market capitalization, haven't been eager for deals. And the U.K.'s **AstraZeneca** successfully fought back a $117 billion hostile bid from Pfizer last year. For smaller drugmakers, however, an inversion target may be easier to find. "Unfortunately, when our corporate tax rate is as high as it is, I think companies feel like they need to set aside their loyalty to America for their more immediate loyalty to shareholders," says Andrew Weisenfeld, a partner at investment banking firm MTS Health Partners.

But Henrietta Treyz, an analyst at Height Securities in Washington, says Congress may reform tax laws to make it harder to invert by 2017. "Given it takes 6 to 12 months to do an inversion deal," she says, "if you're a company that wants to invert, you need to do so right now." —*Cynthia Koons and Michelle Fay Cortez, with Jennifer Epstein, Joe Brennan, and Caroline Chen*

The bottom line To avoid U.S. corporate taxes of up to 35 percent, some drugmakers technically move to Ireland, which has a 12.5 percent rate.

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