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9B18B008

Tax for the CFO: Should Pfizer Acquire Allergan?[[1]](#endnote-1)

Michael Saunders wrote this case under the supervision of Professors Matthew Sooy and Mitchell Stein solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On November 20, 2015, Frank D’Amelio, chief financial officer (CFO) of Pfizer Inc. (Pfizer), needed to prepare a recommendation about whether to proceed with or stop merger talks between Pfizer and Allergan plc (Allergan), a pharmaceutical company with headquarters in New Jersey but tax residence in Ireland. Informal talks had been going on for almost a month, but both sides were rapidly approaching the pre-arranged deadline. The two teams had less than a week to either formally agree to proceed with a merger or walk away. Formalizing the agreement meant activating a US$400 million[[2]](#endnote-2) breakup clause that would make it costlier to call the deal off at a later date.

Pfizer needed a big move—its revenues had declined over the last three years (see Exhibit 1), the stock price had been relatively flat, and investors were growing restless. D’Amelio needed a deal that would improve the company’s financial performance and competitive position among other global pharmaceutical giants. There were not many targets large enough to provide the results that Pfizer needed; after the previous year’s failed merger with AstraZeneca, there was a feeling that the time was now. Both sides were close to an agreement—a $152-billion primarily stock-for-stock merger.[[3]](#endnote-3)

Allergan’s Irish tax residency made this merger both attractive and concerning. While it provided the opportunity to lower Pfizer’s worldwide tax rate, the U.S. Treasury Department (the U.S. Treasury) had recently announced a number of regulatory changes targeting mergers that relocated a company’s tax residence to a low-tax country (called “tax inversions”). Although the legal team disputed that the Allergan deal should be labelled a tax inversion, few disputed that many of the merger’s benefits stemmed from tax savings generated by moving the tax residence of Pfizer’s operations to Ireland.[[4]](#endnote-4) The U.S. Treasury’s regulatory changes appeared to be directly targeting other tax-motivated mergers that were under review, but Pfizer’s legal team was confident that the announced changes would not affect the proposed merger with Allergan. They were less certain about if—and when—the U.S. Treasury might make changes again.

Pfizer

Founded in New York in 1849, Pfizer began in the pharmaceutical business with a candied treatment for an intestinal illness common in that period.[[5]](#endnote-5) By 2014, Pfizer—still headquartered in New York—had grown to become a *Fortune* 100 company with over 78,000 employees, almost $50 billion in annual revenues, and a footprint in over 100 countries.[[6]](#endnote-6) Pfizer’s business now included medications including Viagra, the pain drug Lyrica, and Prevnar, a pneumococcal vaccine. Pfizer’s vision for the future was comprehensive: “Through working in partnership with everyone from patients to health care providers and managed care organizations to world governments and non-governmental organizations, our [Pfizer’s] goal is to ensure that people everywhere have access to innovative treatments and quality health care.”[[7]](#endnote-7)

Although Pfizer had a storied history, it now needed growth, and it had accumulated a war chest of treasury stock and cash that could fund a large acquisition. It had invested considerable time and resources in the failed 2014 attempt to acquire AstraZeneca, which would have also lowered Pfizer’s tax rate considerably. However, that deal was ultimately undone by resistance from AstraZeneca’s senior leadership and political protectionism in the United Kingdom.

Allergan

Allergan was formed in 2013 in a merger of two large pharmaceutical companies—Actavis, Inc. and Warner Chilcott plc. Although Allergan’s operations were large (21,600 employees, $13.1 billion revenue in 2014, and a commercial footprint in over 60 countries), they were still considerably smaller than Pfizer’s.[[8]](#endnote-8) Allergan was legally domiciled in Ireland, where it kept a small office, but maintained headquarters in New Jersey, less than 50 miles from Pfizer’s corporate headquarters. Allergan’s portfolio of pharma businesses and products included brands such as Botox and the Alzheimer’s drug Namenda. More importantly, Allergan had focused its strategy on fast-growing brands that would yield top-line growth in future years. These properties mapped well into the “growth pharma” strategy of Allergan’s chief executive officer (CEO) Brent Saunders, whereby Allergan targeted rapidly growing pharma and pharma tech brands, similar to a portfolio (see Exhibit 2).[[9]](#endnote-9)

Industry and Economic Indicators

The U.S. pharmaceutical and biotech industries were growing rapidly and experiencing both intensifying competition and accelerating consolidation. In 2015, these industries reported annual revenues of $65 billion and $98 billion, respectively—4.1 per cent above 2010 levels—and they were projecting an additional 5.7 per cent growth by 2020. Seventy-two per cent of all research and development expenditures in the industries focused on human health technology, the segment in which Pfizer and Allergan primarily competed.[[10]](#endnote-10)

Growth in the human health technologies segment was largely linked to population age, where aging consumers tended to have greater health care needs and disposable income. The population of individuals aged 65 or older was expected to grow worldwide; in the United States, the 65+ demographic was expected to grow 18 per cent by 2020. Meanwhile, both the number of people with private health insurance (+1 per cent per year) and U.S. federal funding for Medicare and Medicaid products (+10 per cent in 2015) were increasing and projected to continue growing (see Exhibit 3).[[11]](#endnote-11)

More generally, there were positive signs that the United States was in an economically healthy period. U.S. unemployment was at a five-year low (5 per cent) and U.S. equity markets had experienced sustained growth over the past three years, with the New York Stock Exchange index crossing the 10,000 mark.[[12]](#endnote-12)

The Merger

Merger teams for Pfizer and Allergan had tentatively agreed to a $152-billion all-stock deal. Pfizer would pay the equivalent of $363.63 per share of Allergan, representing a 30-per-cent premium over Allergan’s pre-announcement share price.[[13]](#endnote-13) Allergan shareholders would receive roughly 11 shares of the combined company for each of their current Allergan shares, corresponding to approximately 44 per cent of the shares of the combined company.[[14]](#endnote-14)

While the newly merged company would retain its administrative headquarters in New York, for tax purposes it would be a resident of Ireland. The proposed deal did not call for new layoffs at either company, with Allergan’s CEO expected to accept a chief operating officer (COO) role at the combined company. COOs often acted as an understudy to the CEO—although Pfizer’s CEO Ian Read had not announced any immediate retirement plans, he was over 60 years old; offering Allergan CEO Saunders the COO role seemed to meet transition needs as Pfizer looked for leadership in the medium and long term.

The deal would add several valuable high-growth products to Pfizer’s product portfolio, but most of the financial benefits of the merger would come from lowering tax rates on Pfizer’s international operations. By relocating its tax residence to Ireland, Pfizer’s worldwide tax rate was estimated to drop from 25 per cent to 18 per cent in the first year alone.[[15]](#endnote-15) The highest Irish and U.S. corporate tax rates at the time of the merger were 12.5 per cent and 40 per cent, respectively.[[16]](#endnote-16) Analysts’ best estimate for Pfizer’s cost of capital was currently 8.5 per cent.[[17]](#endnote-17)

Pfizer’s income tax savings were estimated to be $1.4 billion in the first year following the merger, increasing to $2 billion by the third year.[[18]](#endnote-18) Pfizer would also obtain all of Allergan’s future revenues and profits. The combined revenue and profits of the merged company were expected to total $68 billion and $21 billion, respectively.[[19]](#endnote-19) Thus, the merger would help Pfizer keep up with the large players in the pharmaceutical and biotech industries.

Lastly, the tax savings would also greatly reduce costs to repatriate the $74 billion in overseas cash holdings that Pfizer had accumulated. While Pfizer’s 25 per cent effective tax rate was higher than that of its peers, it was well below Pfizer’s marginal U.S. tax rate (40 per cent). One way that Pfizer kept taxes low was by avoiding the repatriation of international profits (described in greater detail below). However, if its tax residency were moved to Ireland, Pfizer would pay 12.5 per cent instead of 40 per cent to repatriate these funds, potentially freeing up cash for other uses.[[20]](#endnote-20)

Transfer Pricing and Capital Repatriation

Tax rates differed across countries, creating both challenges and opportunities for multinational companies. Generally, companies paid income tax in the countries where profits were earned, no matter the location of their tax residence. Depending on the tax rules in their country of residence, companies might also have to pay additional tax in their country of residence. This was often the case when a company “repatriated” profits from a foreign country to its country of residence.[[21]](#endnote-21) Because the United States had among the highest corporate income tax rates in the world, multinational firms that either were a resident of the United States or had U.S. operations benefited from tax strategies that shifted income to lower tax countries, either temporarily or permanently.

One commonly used strategy to temporarily defer U.S. taxation on profits was through what was known as “transfer pricing” on the sale of goods or services between, for example, a U.S. parent and its foreign subsidiary. Transfer pricing balanced differing jurisdictional requirements by moving a portion of a firm’s operations into a foreign jurisdiction, so that the subsidiary could charge the U.S. parent for purchases of goods or services. Although transfer pricing often required substantive operational changes (e.g., opening an office or increasing head count in a foreign jurisdiction), it could also enable the company to shift profits to the lower-taxed foreign subsidiary by having more income in the foreign country and more expenses in the United States.

However, one consequence of this type of tax planning strategy was that profits became “locked” into the low-tax country. They would be subject to higher U.S. taxes if they were repatriated to the United States. In Pfizer’s case, the stockpile of foreign-held profits totaled $74 billion.

Tax Inversions

U.S. tax rates were among the highest in the world. Consequently, one strategy for companies residing in the United States was to change their tax residence to a country with a lower tax rate. While there were many laws and regulations governing tax residency that made changing tax residency challenging, firms could do so under certain circumstances. One way a company could move its tax residency was through a tax inversion, which was accomplished by merging with a company that was already a resident of a low tax-rate country and then using the lower tax country as the tax residence for the combined entity. When this occurred, the newly merged entity was no longer required to pay U.S. tax rates on profits earned outside the United States. Consequently, tax inversions had the potential to reduce taxes both on future profits that would be earned after the merger and on cash stockpiles that had already been earned but that were being held offshore to avoid triggering repatriation taxes.

Transfer pricing strategies that shifted income to countries with lower tax rates could have a significant impact on the taxes a corporation paid in the year it earned profits (see Exhibit 4, columns A and B), but tax savings only lasted until profits were repatriated. Transfer pricing strategies could be used in conjunction with changing a company’s tax residency (see Exhibit 4, columns B and C) to reduce tax rates even further by moving the company to a country with low tax rates, minimizing or eliminating the effects of repatriating foreign profits in the United States. Almost 50 multinational firms completed tax inversions in the last 10 years, including well-recognized brands such as Eaton, Burger King, and Medtronic; and about half of the transactions took place in the last few years. Several other tax inversions were presently proposed, including deals with Johnson Controls ($16.5 billion), Waste Connections ($2.7 billion), and IHS Markit Ltd. ($13 billion).[[22]](#endnote-22)

Tax planning through means such as transfer pricing was often used to help companies such as Pfizer lower their effective tax rate (Pfizer’s effective tax rate was approximately 25 per cent, despite facing a U.S. marginal tax rate of 40 per cent). However, this was still higher than the effective tax rate of its competitors with international tax residences, such as GlaxoSmithKline plc of Britain (5 per cent), Novartis AG of Switzerland (12.5 per cent), and Allergan of Ireland (5 per cent). Pfizer’s CEO noted that cash used to pay taxes was money that could not be used to fund acquisitions or share buybacks, disadvantaging Pfizer relative to its competitors. Nevertheless, Pfizer’s effective tax rate was similar to U.S. resident peers, such as Merck & Co., Inc. (30 per cent).[[23]](#endnote-23)

U.S. Regulatory Environment

Although regulators such as the Federal Trade Commission and the U.S. Department of Justice often reviewed mergers for any adverse impact on competition, Pfizer’s proposed merger with Allergan was not expected to raise monopoly concerns. Instead, the deal faced uncertainty with the U.S. Treasury, which was becoming increasingly concerned about tax-motivated mergers.

Tax inversions such as these were both increasing in frequency (see Exhibit 5) and increasingly drawing political ire. In the United States, President Barak Obama and presidential candidates including Hillary Clinton and Donald Trump frequently commented on mergers.[[24]](#endnote-24) Those comments led to regulatory action such as the U.S. Treasury’s new rules titled *Additional Treasury Actions to Reign in Corporate Tax Inversions*. These measures appeared to directly target proposed tax inversions by reducing the ability of firms to move their tax domicile into countries where they had little economic activity, particularly when merging with much smaller firms.[[25]](#endnote-25)

After reviewing the changes, both legal teams were confident that the new rules would not interfere with the proposed deal because Allergan shareholders would own more than 40 per cent of the combined company (a threshold established in the updated regulations). Saunders put it well when he said, “We built this deal around the law, the regulations, [and] all the notices that were put out by the U.S. Treasury, and it was a highly legal construct.” He added, “We followed the rules that Congress had set for companies looking to move to foreign domicile.”[[26]](#endnote-26)

Advisors in lobbyist networks reported general consensus among U.S. congressional representatives that tax inversions required action, but the advisors expressed considerable disagreement on how to deal with inversions. Republicans, who controlled the House of Representatives but not the Senate, preferred a comprehensive solution that would not target specific deals.[[27]](#endnote-27) However, any proposed solution would require Congressional coalition building, compromise, and—most of all—time. The U.S. Treasury changes could come more quickly, because regulatory agencies operated more like traditional organizations—with centralized decision making (see Exhibit 6).

D’Amelio’s legal team explained that legal changes such as the announced regulatory changes typically applied only to deals finalized after the announcement date. Therefore, if Pfizer could accelerate the merger work from nine months to six, Pfizer might be able to finalize the merger before either the politicians or the regulators could finalize new policy.

Much To Consider

Although D’Amelio’s legal team avoided the tax inversion label, the deal carried many of the tax inversion hallmarks. In fact, the press was already describing the deal as the largest so-called inversion deal ever.[[28]](#endnote-28)

But were the tax savings worth the $152-billion price tag? It was imperative to calculate the potential tax savings on repatriating offshore profits, as well as to calculate the tax savings on any future profits. To compute tax savings on future profits, D’Amelio needed to assign a present value—requiring a forecast of future profits, an estimate of what the future effective tax rate would be, and a discount rate to account for future benefits. Lastly, he also needed to consider what assumptions were critical to the $152-billion price tag, including his confidence that the expected tax benefits would still be available when the deal would be finalized.

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The authors would like to thank Adam Khimji for his assistance in the development of this case.

EXHIBIT 1: PFIZER inc. FINANCIAL STATEMENTS

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Consolidated Statements of Income** | | | | | | |
| Pfizer Inc. and Subsidiary Companies | | | | | | |
|  |  |  |  |  | |  |
| (in US$ Millions, Except per Common Share Data) | | **Year Ended December 31** | | | | |
|  |  |  | **2014** | **2013** | **2012** | |
| Total Revenues |  | $49,605 | | $51,584 | | $54,657 |
| Expenses |  |  |  |  |  | |
| Cost of Sales |  | $9,577 | | $9,586 | | $9,821 |
| Selling and Administrative Expense |  | $14,097 | | $14,355 | | $15,171 |
| Research & Development |  | $8,393 | | $6,678 | | $7,482 |
| Other |  |  | $5,298 | $5,249 | $10,941 | |
| **Earnings before Tax** |  | **$12,240** | | **$15,716** | | **$11,242** |
| Provision for Income Tax |  | $3,120 | | $4,306 | | $2,221 |
| **Net Income** |  | **$9,120** | | **$11,410** | | **$9,021** |
|  |  |  |  |  |  | |
| Discontinued Operations (Net of Tax) |  | $48 | | $10,662 | | $5,577 |
| Net Income Attributable to Non-controlling Interests | | $32 | | $69 | | $28 |
| **Net Income Attributable to Pfizer** |  | **$9,136** | | **$22,003** | | **$14,570** |
|  |  |  |  |  |  | |
| Weighted Average Basic Shares |  | 6,346 | | 6,813 | | 7,442 |
| Weighted Average Diluted Shares |  | 6,424 | | 6,895 | | 7,508 |
| **Earnings per Share (Basic)** |  | **$1.44** | | **$3.23** | | **$1.96** |
| Earnings per Share (Diluted) |  | $1.42 | | $3.19 | | $1.94 |

EXHIBIT 1 (Continued)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Consolidated Balance Sheets** | | | | | |
| Pfizer Inc. and Subsidiary Companies | | | | | |
| (in US$ Millions, Except per Common Share Data) | | | **Year Ended December 31** | | |
|  |  |  | **2014** | | **2013** |
| **Assets** |  |  | |  |  |
| Current Assets | |  |  | |  |
| Cash & Equivalents | |  | $3,343 | | $2,183 |
| Short-Term Investments | |  | $32,779 | | $30,225 |
| Net Receivables | |  | $8,669 | | $9,357 |
| Inventory | |  | $5,663 | | $6,166 |
| Deferred Tax Assets | |  | $4,498 | | $4,624 |
| Other |  |  | $2,750 | | $3,689 |
| Total Current Assets | |  | $57,702 | | $56,244 |
| Long-term Investments | |  | $17,518 | | $16,406 |
| Net Property, Plant, & Equipment | |  | $11,762 | | $12,397 |
| Goodwill & Net Intangible Assets | |  | $77,235 | | $81,904 |
| Non-current Deferred Tax Assets | |  | $1,544 | | $1,554 |
| Other |  |  | $3,513 | | $3,596 |
| **Total Assets** | |  | **$169,274** | | **$172,101** |
| **Liabilities & Equity** | |  |  | |  |
| Current Liabilities | |  |  | |  |
| Short-Term Borrowings | |  | $5,141 | | $6,027 |
| Accounts Payable | |  | $3,440 | | $3,234 |
| Dividends Payable | |  | $1,711 | | $1,663 |
| Taxes Payable | |  | $531 | | $678 |
| Other |  |  | $10,808 | | $11,764 |
| Total Current Liabilities | |  | $21,631 | | $23,366 |
| Long-Term Debt | |  | $31,541 | | $30,462 |
| Net Pension and Post-Retirement Obligations | | | $10,264 | | $7,303 |
| Non-current Deferred Tax Liabilities | |  | $24,981 | | $25,590 |
| Other non-current Liabilities | |  | $9,236 | | $8,760 |
| **Total Liabilities** | |  | **$97,653** | | **$95,481** |
| Preferred Stock | |  | $29 | | $33 |
| Common Stock | |  | $455 | | $453 |
| Additional Paid-in Capital | |  | $78,977 | | $77,283 |
| Treasury Stock | |  | $(73,021) | | $(67,923) |
| Retained Earnings | |  | $72,176 | | $69,732 |
| Accumulated Other Comprehensive Loss | | | $(7,316) | | $(3,271) |
| **Total Equity** | |  | **$71,300** | | **$76,307** |
| Attributable to Non-controlling Interest | |  | $321 | | $313 |
| **Total Liabilities & Equity** | |  | **$169,274** | | **$172,101** |

EXHIBIT 1 (Continued)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidated Statement of Cash Flows** | | | | |
| Pfizer Inc. and Subsidiary Companies | | | | |
|  |  |  |  |  |
| (in US$ Millions, Except per Common Share Data) | |  | **Year Ended December 31** | |
|  |  |  | **2014** | **2013** |
| **Operating Activities** |  |  |  |  |
| Net Income |  |  | $9,168 | $22,072 |
| Depreciation & Amortization |  |  | $5,537 | $6,410 |
| Asset Write-Offs |  |  | $531 | $1,145 |
| Deferred Taxes |  |  | $320 | $1,726 |
| Share-Based Compensation |  |  | $586 | $523 |
| Benefit Plan Contributions |  |  | $(199) | $296 |
| Other |  |  | $(484) | $(11,110) |
| Accounts Receivable |  |  | $148 | $940 |
| Inventory |  |  | $175 | $(538) |
| Other Assets |  |  | $1,156 | $(822) |
| Accounts Payable |  |  | $297 | $382 |
| Other Liabilities |  |  | $(353) | $(3,340) |
| **Operating Cash Flows** |  |  | **$16,882** | **$17,684** |
| **Investing Activities** |  |  |  |  |
| Purchase of Property, Plant, & Equipment | |  | $(1,199) | $(1,206) |
| Purchase of Short-Term Investments | |  | $(50,954) | $(42,761) |
| Proceeds from Redemption of Short-Term Investments | | | $47,374 | $41,127 |
| Purchase of Long-Term Investments |  |  | $(10,718) | $(11,020) |
| Proceeds from Redemption of Long-Term Investments | | | $6,145 | $7,555 |
| Other |  |  | $3,698 | $(4,239) |
| **Cash Flows from Investing Activities** |  |  | **$(5,654)** | **$(10,544)** |
| **Financing Activities** |  |  |  |  |
| Net Proceeds from Short-Term Borrowings | |  | $(1,828) | $7,798 |
| Principal Payments on Short-Term Borrowings | |  | $(10) | $(4,234) |
| Proceeds from Issuance of Long-Term Debt | |  | $4,491 | $6,618 |
| Principal Payments on Long-Term Borrowings | |  | $(2,104) | $(4,146) |
| Purchase of Common Stock |  |  | $(5,000) | $(16,290) |
| Dividends Paid |  |  | $(6,609) | $(6,580) |
| Other |  |  | $1,074 | $1,859 |
| **Cash Flows from Financing Activities** |  |  | **$(9,986)** | **$(14,975)** |
| Change in Cash and Equivalents |  |  | $1,242 | $(7,835) |
| Beginning Cash |  |  | $2,183 | $10,081 |
| **Resulting Cash Flow** |  |  | **$3,425** | **$2,246** |

EXHIBIT 1 (Continued)

Note: \*Estimated, based on site data collected from “Careers,” Pfizer, accessed June 4, 2017, <http://pfizercareers.com/career-types/our-locations>.

Source: Created by the case authors using data from Pfizer Inc. and Subsidiary Companies, *2014 Financial Report*, 2014, accessed April 20, 2018, https://s21.q4cdn.com/317678438/files/doc\_financials/Annual/2014/2014\_Pfizer\_Financial\_Report.pdf.

**EXHIBIT 2:** ALLERGAN FINANCIAL STATEMENTS

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Consolidated Statements of Income** | | | | | | | |
| Allergan Inc. and Subsidiary Companies | | | | | | | |
|  |  |  |  | |  |  | |
| (in US$ Millions, Except per Common Share Data) | **Year Ended December 31** | | | | | | |
|  |  |  | **2014** | | **2013** | **2012** | |
| Total Revenues |  | $13,062 | | | $8,678 | | $5,9145 |
| Expenses |  |  | | |  | |  |
| Cost of Sales |  | $6,304 | | | $4,691 | | $3,394 |
| Selling and Administrative Expense |  | $1,743 | | | $1,028 | | $625 |
| Research & Development |  | $1,086 | | | $617 | | $403 |
| Other |  |  | $5,642 | | $2,981 | $1,248 | |
| **Earnings before Tax** |  | **$(1,712)** | | | **$(638)** | | **$245** |
| Provision for Income Tax |  | $(82) | | | $113 | | $147 |
| **Net Income** |  | **$(1,631)** | | | **$(751)** | | **$98** |
| Attributable to Non-controlling Interest | $(0) | | | | $1 | | $(1) |
| **Net Income Attributable to Pfizer** |  | $(1,631) | | | $(750) | | $97 |
|  |  |  |  | |  |  | |
| Weighted Average Basic Shares |  | 220 | | | 42 | | 126 |
| Weighted Average Diluted Shares | 220 | | | 142 | | | 128 |
| **Earnings per Share (Basic)** |  | **$(7.42)** | | | **$(5.27)** | | **$0.76** |
| Earnings per Share (Diluted) |  | $(7.42) | | | $(5.27) | | $0.76 |

EXHIBIT 2 (Continued)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidated Balance Sheets** | | | | |
| Allergan Inc. and Subsidiary Companies | | | | |
|  |  |  |  |  |
| (in US$ Millions, Except per Common Share Data) | | | **Year Ended December 31** | |
|  |  |  | **2014** | **2013** |
| **Assets** |  |  |  |  |
| Current Assets | |  |  |  |
| Cash & Equivalents | |  | $250 | $329.0 |
| Short-Term Investments | |  | $1 | $3 |
| Net Receivables | |  | $2,372 | $1,405 |
| Inventory | |  | $2,076 | $1,786 |
| Deferred Tax Assets | |  | $500 | $232 |
| Other |  |  | $1,683 | $680 |
| **Total Current Assets** | |  | **$6,882** | **$4,435** |
| Long-Term Investments | |  | - | - |
| Net Property, Plant, & Equipment | |  | $1,595 | $1,617 |
| Goodwill & Net Intangible Assets | |  | $43,710 | $16,432 |
| Non-current Deferred Tax Assets | |  | $107 | $105 |
| Other |  |  | $235 | $138 |
| **Total Assets** | |  | **$52,529** | **$22,726** |
| **Liabilities & Equity** | |  |  |  |
| Current Liabilities | |  |  |  |
| Current Portion of Long-Term Debt | |  | $697 | $535 |
| Accounts Payable | |  | $4,171 | $2,343 |
| Taxes Payable | |  | $50 | $97 |
| Other |  |  | $100 | $321 |
| **Total Current Liabilities** | |  | **$5,019** | **$3,295** |
| Long-Term Debt | |  | $14,846 | $8,517 |
| Other Taxes Payable | |  | $892 | $187 |
| Non-current Deferred Tax Liabilities | |  | $3,062 | $823 |
| Other Non-current Liabilities | |  | $375 | $366 |
| **Total Liabilities** | |  | **$24,194** | **$13,189** |
| Common Stock | |  | - | - |
| Additional Paid-in Capital | |  | $28,995 | $8,013 |
| Treasury Stock | |  | - | $(3) |
| Retained Earnings | |  | $(198) | $1,432 |
| Accumulated Other Comprehensive Loss | | | $(465) | $91 |
| **Total Equity** | |  | **$28,331** | **$9,532** |
| Attributable to Non-controlling Interest | | | $4 | $5 |
| **Total Liabilities & Equity** | |  | **$52,529** | **$22,726** |

EXHIBIT 2 (Continued)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidated Balance Sheets** | | | | |
| Allergan Inc. and Subsidiary Companies | | | | |
|  |  |  |  |  |
| (US$ Millions, Except per Common Share Data) | | | **Year Ended December 31** | |
|  |  |  | **2014** | **2013** |
| **Operating Activities** |  |  |  |  |
| Net Income |  |  | $(1,630) | $(751) |
| Depreciation & Amortization |  |  | $3,814 | $1,312 |
| Deferred Taxes |  |  | $(690) | $(275) |
| Share-Based Compensation |  |  | $368 | $134 |
| Research & Development Impairments |  |  | $424 | $5 |
| Other |  |  | $389 | $953 |
| Accounts Receivable |  |  | $(611) | $19 |
| Inventory |  |  | $(207) | $(213) |
| Other Assets |  |  | $29 | $50 |
| Accounts Payable |  |  | $417 | $(20) |
| Other Liabilities |  |  | $(60) | $1 |
| **Operating Cash Flows** |  |  | **$2,243** | **$1,213.5** |
| **Investing Activities** |  |  |  |  |
| Purchase of Property, Plant, & Equipment | |  | $(239) | $(178) |
| Purchase of Securities |  |  | $(1) | - |
| Proceeds from Sale of Securities |  |  | $12 | $33 |
| Acquisitions of Businesses |  |  | $(5,562) | $(15) |
| Proceeds on Sale of Assets |  |  | $455 | $12 |
| Other |  |  | $(36) | $(127) |
| **Cash Flows from Investing Activities** |  |  | **$(5,371)** | **$(275)** |
| **Financing Activities** |  |  |  |  |
| Net Proceeds from Short-Term Borrowings | |  | $1,280 | $555 |
| Principal Payments on Short-Term Borrowings | | | $(6,127) | $(3,230) |
| Proceeds from Issuance of Long-Term Debt | |  | $8,076 | $1,882 |
| Purchase of Common Stock |  |  | $(130) | $(170) |
| Other |  |  | $(82) | $95 |
| **Cash Flows from Financing Activities** |  |  | **$3,018** | **$(867)** |
| Movement in Cash Held for Sale |  |  | $31 | $(61) |
| Change in Cash and Equivalents |  |  | $(79) | $10 |
| Beginning Cash |  |  | $329 | $319 |
| **Resulting Cash Flow** |  |  | **$250** | **$329** |

EXHIBIT 2 (Continued)

Source: Created by the case authors using data from Allergan, *2014 Annual Report*, 2014, https://www.allergan.com/investors/financial-information/annual-reports.

EXHIBIT 3: PHARMA and BIOTECH INDICATORS

Note: Growth of approximately 5,150 per year

Source: Created by the case authors using data from United States Census Bureau, Demographic Internet Staff, “2014 National Population Projections: Summary Tables—People and Households, July 6, 2012, accessed May 1, 2017, https://www.census.gov/population/projections/data/national/2014/summarytables.html.

EXHIBIT 4: TAX INVERSIONS, PROFIT STRIPPING, and CAPITAL REPATRIATION (in US$ millions)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **(A)** | | |  | | **(B)** | | | |  | |  | | **(C)** | | | |
|  | **Multinational Firm**  **Resident in the United States\*** | | |  | | **Multinational Firm**  **Resident in the United States with Transfer Pricing** | | | |  | |  | | **Multinational Firm**  **Resident in Ireland with**  **Transfer Pricing** | | | |
| **Country** | **Ireland** | **Canada** | **United States** | |  | | **Ireland** | **Canada** | **United States** | |  | |  | | **Ireland** | **Canada** | **United States** | |  |
| **Profit Assigned to Country** | $100 | $100 | $100 | |  | | $200 | $50 | $50 | |  | |  | | $200 | $50 | $50 | |  |
| **Tax Rate in Country** | 12.5% | 25% | 40% | |  | | 12.5% | 25% | 40% | |  | |  | | 12.5% | 25% | 40% | |  |
| **Tax Paid at Year End** | $12.5 | $25.0 | $40.0 | |  | | $25.0 | $12.5 | $20.0 | |  | |  | | $25.0 | $12.5 | $20.0 | |  |
| **U.S. Tax Paid Later\*\* (When Repatriated)**  (% Computation in Parentheses) | $27.5  27.5%  (40%–  12.5%) | $15.0  15.0%  (40%–25%) | $0.0  0.0%  (40%–40%) | |  | | $55.0  27.5%  (40%–12.5%) | $7.5  15.0%  (40%–25%) | $0.0  0.0%  (40%–40%) | |  | |  | | $0.0  0.0%  (paid domestic taxes already) | $0.0  0.0%  (paid higher rate abroad) | $0.0  0.0%  (paid higher rate abroad) | |  |
| **Total Taxes Paid** | $40.0 | $40.0 | $40.0 | |  | | $80.0 | $20.0 | $20.0 | |  | |  | | $25.0 | $12.5 | $20.0 | |  |
|  | **$120**  40.0% | | |  | | **$120**  40.0% | | | |  | |  | | **$57.5**  19.2% | | | |

$0.0

Later

$57.5

Now

$62.5

Later

$57.5  
 Now

$42.5

Later

$77.5

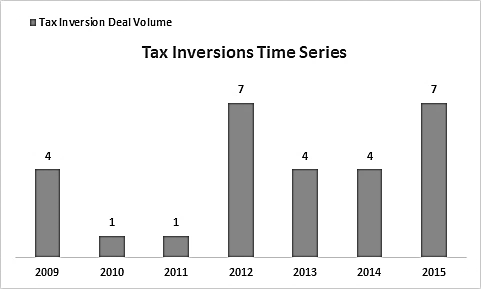
Now

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Transfer pricing reduces taxes paid in current year by shifting domestic income into countries with lower tax rates, but savings only last until profits are repatriated. |  | By relocating tax domicile to a country that does not tax foreign profits (or at a lower tax rate), foreign earned profits are not subject to repatriation taxes. |  |

Note: \*Income earned overseas is taxed at the foreign country’s corporate tax rate in the year the income is earned. If the domestic tax rate is greater than the foreign tax rate, the entity may be required to pay a repatriation tax on overseas profits when they are used/repatriated; \*\*If an entity delays the repatriation of overseas cash, it will reduce the present value of the repatriated taxes. This has been ignored in this exhibit.

Source: Created by the case authors.

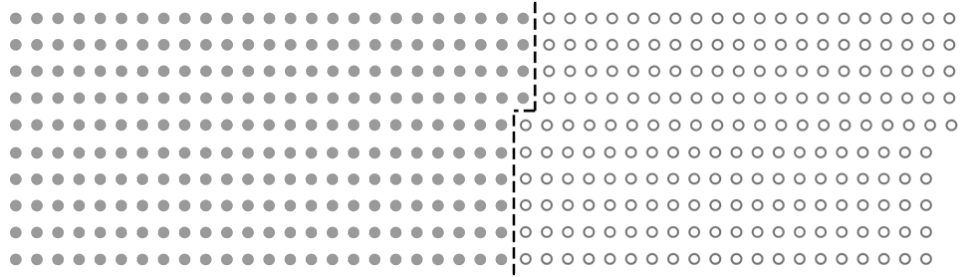
EXHIBIT 5: RECENT TAX INVERSIONS



Source: Created by the case authors using data from Zachary Mider, “Tax Inversion,” March 2, 2017, Bloomberg, March 2, 2017, accessed May 6, 2017, https://www.bloomberg.com/quicktake/tax-inversion.

EXHIBIT 6: U.S. CONGRESSIONAL AND REGULATORY STRUCTURE in 2015

U.S. House of Representatives (435 members)



**51%**

Needed to pass legislation

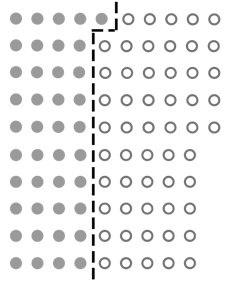
**201**

Republican

**234**

Democrat

U.S. Senate in 2015 (99 members)



**60%**

Needed to bring to vote

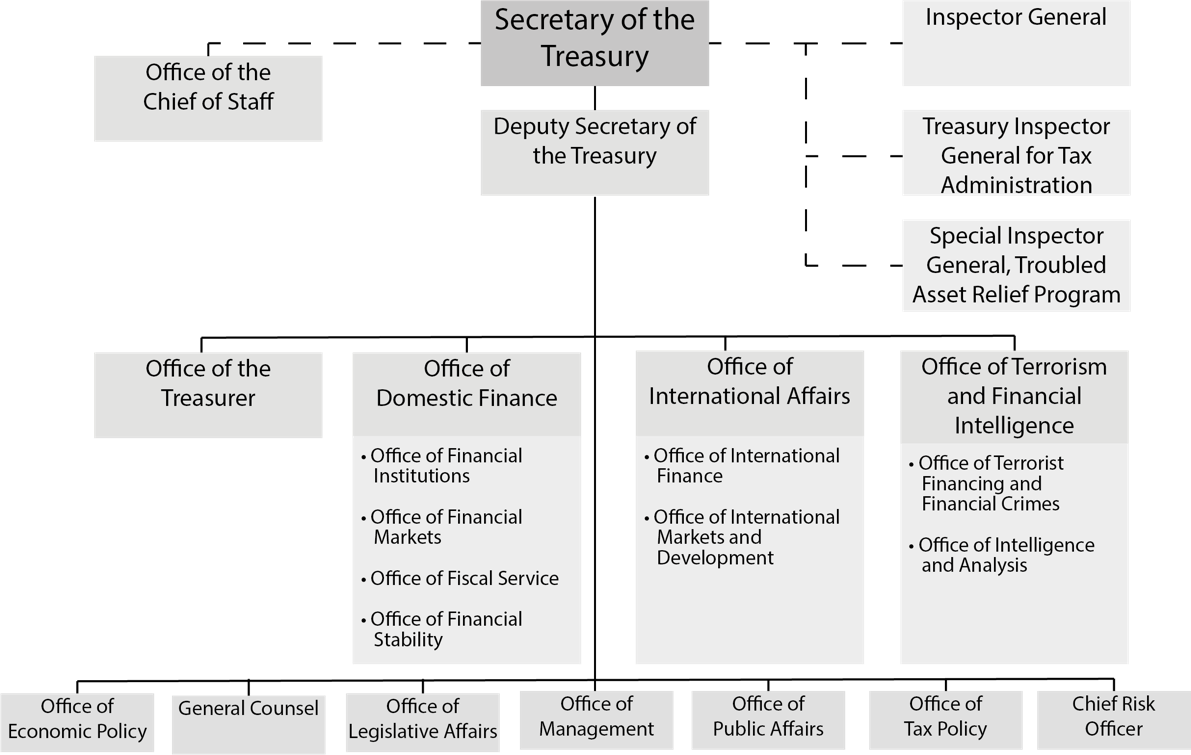
**54**

Republican

**45**

Democrat

U.S. Treasury Department Organizational Chart



Source: Created by the case authors using data from U.S. Department of the Treasury, accessed May 1, 2017, https://www.treasury.gov/about/organizational-structure/Pages/default.aspx

Endnotes

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Pfizer Inc. or any of its employees. [↑](#endnote-ref-1)
2. All currency amounts are in U.S. dollars, unless otherwise specified. [↑](#endnote-ref-2)
3. Cynthia Koons and Michelle Fay Cortez, “Pfizer and Allergan to Combine with Joint Value of $160 Billion,” Bloomberg, Nov. 2015. Web. 01 May 2017, https://www.bloomberg.com/news/articles/2015-11-22/pfizer-allergan-said-to-be-close-to-150-billion-merger. [↑](#endnote-ref-3)
4. “Press Center,” U.S. Department of the Treasury, accessed May 1, 2017, https://www.treasury.gov/press-center/Pages/default.aspx. [↑](#endnote-ref-4)
5. “Company Fact Sheet,” Pfizer, accessed May 1, 2017, https://www.pfizer.com/about/leadership-and-structure/company-fact-sheet. [↑](#endnote-ref-5)
6. “Form 10K,” SEC Edgar, accessed May 27, 2017, https://www.sec.gov/Archives/edgar/data/78003/000007800314000018/

   pfe-12312013x10k.htm; and “Corporate Infographic,” Pfizer, accessed April 23, 2018, https://www.pfizer.ie/UserFiles/File/Pfizer%20

   Corporate%20Infographic%20v2.pdf. [↑](#endnote-ref-6)
7. “Mission Statement & Values,” Pfizer, accessed May 27, 2017, https://www.pfizer.ie/mission\_statement\_and\_values.cfm. [↑](#endnote-ref-7)
8. “Form 10K” SEC Edgar, accessed May 27, 2017, https://www.sec.gov/Archives/edgar/data/1578845/000119312515052898/d8428

   74d10k.htm. [↑](#endnote-ref-8)
9. “Brent Saunders, Parkland Grad, Is the Lehigh Valley's $150 Billion Dealmaker,” The Morning Call, accessed May 27, 2017, www.mcall.com/business/mc-brent-saunders-making-deals-at-allergan-20151017-story.html. [↑](#endnote-ref-9)
10. IBIS World, “Biotechnology in the US,” accessed May 1, 2017. http://clients1.ibisworld.com.proxy1.lib.uwo.ca/reports/us/industry/

    default.aspx?entid=2001. [↑](#endnote-ref-10)
11. Demographic Internet Staff, “2014 National Population Projections: Summary Tables—People and Households,” U.S. Census Bureau, July 6, 2012, accessed May 1, 2017. https://www.census.gov/topics/population/age-and-sex/data/tables.html. [↑](#endnote-ref-11)
12. Michelle Jamrisko, “U.S. Economy Grew 2% in Third Quarter, Led by Consumer Spending,” Bloomberg, August 22, 2015, accessed May 6, 2017. [↑](#endnote-ref-12)
13. “Allergan plc Ordinary Shares,” Google, accessed May 27, 2017, https://www.google.ca/search?q=“Allergan+plc+Ordinary+Shares%2C”+

    Google&rlz=1C1CHBF\_enCA787CA787&oq=“Allergan+plc+Ordinary+Shares%2C”+Google&aqs=chrome.69i57.270j0j4&sourceid=chrome&ie=UTF-8. [↑](#endnote-ref-13)
14. Ransdell Pierson and Bill Berkrot, "Pfizer to Buy Allergan in $160 Billion Deal,” Reuters, November 24, 2015, accessed May 27, 2017, https://www.reuters.com/article/allergan-ma-pfizer/update-5-pfizer-to-buy-allergan-in-160-billion-deal-idUSL3N13I2Z320151123. [↑](#endnote-ref-14)
15. Ibid. [↑](#endnote-ref-15)
16. “Canadian Corporate Tax Tables,” KPMG, accessed May 27, 2017, https://home.kpmg.com/ca/en/home/services/tax/canadian-corporate-tax-tables.html. [↑](#endnote-ref-16)
17. “GuruFocus Global Premium Membership,” Pfizer Inc. (OSTO:PFE) WACC %, accessed May 6, 2017. https://www.gurufocus.com/term/wacc/AGN/WACC-Percentage/Allergan%20PLC. [↑](#endnote-ref-17)
18. Jen Wieczner, “Here’s How Much More Pfizer Could Save in Taxes with Allergan Deal,” Fortune, February 26, 2016, accessed May 27, 2017, https://ca.finance.yahoo.com/news/much-more-pfizer-could-save-201235739.html. [↑](#endnote-ref-18)
19. Case authors’ estimates, assuming the same weighted average net margin pre-merger. [↑](#endnote-ref-19)
20. Michael J. de la Merced, David Gelles, and Leslie Picker, “Pfizer Chief Defends Merger with Allergan as Good for U.S.,” *The New York Times*, November 23, 2015, accessed May 1, 2017, https://www.nytimes.com/2015/11/24/business/dealbook/pfizer-allergan-merger-inversion.html. [↑](#endnote-ref-20)
21. A common form of repatriating profits was when a foreign subsidiary paid a dividend to its parent corporation. For instance, when a foreign subsidiary in a country with a lower tax rate than the United States repatriated profits to its U.S.-based parent, the company would be subject to additional tax as a result of higher U.S. tax rates. This occurred automatically when the parent organization spent any of the profits, such as for funding share repurchases. [↑](#endnote-ref-21)
22. “Health Care M&A Deal Volume and Value Exploded in 2015,” Irving Levin Associates, Inc., May 7, 2015, accessed May 6, 2017. https://www.levinassociates.com/pr2016/pr1601mam15. [↑](#endnote-ref-22)
23. “Form 10-K”, SEC Edgar, accessed May 27, 2017, https://www.sec.gov/Archives/edgar/data/310158/000031015815000005/mrk

    1231201410k.htm. [↑](#endnote-ref-23)
24. U.S. President Barack Obama commented, “. . . A small but growing group of big corporations are fleeing the country to get out of paying taxes. . . They’re . . . basically renouncing their citizenship and declaring that they’re based somewhere else, just to avoid paying their fair share.” Barack Obama, The President’s Weekly Address, July 26, 2014, accessed June 18, 2018, http://www.presidency.ucsb.edu/ws/?pid=105495; Donald Trump stated “We have so many companies leaving, it is disgraceful,” Caroline Humer and Ransdell Pierson, “Obama’s Inversion Curbs Kill Pfizer’s $160 Billion Allergan Deal,” *Business News*, April 5, 2016, accessed June 18, 2018, https://uk.reuters.com/article/uk-allergan-m-a-pfizer/obamas-inversion-curbs-kill-pfizers-160-billion-allergan-deal-idUKKCN0X22E1; Hilary Clinton said, “Take advantage of loopholes that litter our tax code, distort incentives for investment and disadvantage small businesses and domestic firms that cannot game the international tax system.” Michael J. de la Merced, David Gelles, and Leslie Picker, “Pfizer Chief Defends Merger With Allergan as Good for U.S.,” *The New York Times*, November 23, 2015, accessed June 18, 2018, https://www.nytimes.com/2015/11/24/business/dealbook/pfizer-allergan-merger-inversion.html. [↑](#endnote-ref-24)
25. Richard Rubin, “Obama Renews Call for Congress to Limit Tax Inversions,” The Wall Street Journal, April 5, 2016, accessed May 27, 2017, https://www.wsj.com/articles/president-obama-praises-new-inversion-rules-1459873977. [↑](#endnote-ref-25)
26. Tom DiChristopher and David Faber, “Allergan CEO: Feds Blindsided Us on Pfizer Deal,” CNBC, April 6, 2016, accessed May 27, 2017. [↑](#endnote-ref-26)
27. The United States passed tax legislation two years later, in 2017, that addressed many of the specific regulations at issue in this case. The tax legislation established a lower corporate income tax rate of 21 per cent, and greatly reduced U.S. taxes imposed on foreign-earned income. Nevertheless, two core issues underlying this case and tax management practices are enduring: (1) companies operate in many jurisdictions simultaneously, which operate under different tax laws and with different tax rates; and (2) tax laws evolve frequently, and may evolve differently in each jurisdiction. [↑](#endnote-ref-27)
28. Jackie Wattles and Heather Long, “Pfizer and Allergan Combine in Biggest Drug Merger Ever,” CNN Money, November 23, 2015, accessed May 27, 2017, http://money.cnn.com/2015/11/23/investing/pfizer-allergan-merger/index.html. [↑](#endnote-ref-28)