

The Benefits of Incorporating Abroad in an Age of Globalization

By STEVEN M. DAVIDOFF



Michael Kors Holdings not only sells fashion that people crave, it has also offered shares that were a hit with investors. The company's shareholders, including the designer himself, sold about \$944 million worth of stock last week in an initial public offering that valued the company at about \$4 billion.

Michael Kors is not just a successful I.P.O., however. The company is also a case study on how globalization increasingly allows companies to avoid United States taxes and regulation.

Michael Kors gets about 95 percent of its revenue from sales in Canada and the United States. Like most clothing manufacturers, the company makes its clothes largely in Asia. And Michael Kors has gone one step further. It has outsourced its corporate governance and taxes to the British Virgin Islands.

Because the company is organized there, it sidesteps higher taxes and substantial regulation in the United States.

The tax savings are likely in the millions and could end up being much more.

If Michael Kors were organized under the laws of the United States, it would be subject to taxation on its worldwide income instead of just the revenue it earned in the United States. The company could defer these taxes on foreign income by keeping the money abroad in foreign subsidiaries. If it repatriated the money to the United States, it would then be taxed at rates of up to 35 percent, offset by any foreign tax paid.

Because of this tax regime, JPMorgan Chase estimates that **American multinationals have \$1.375 trillion in cash sitting overseas.** By keeping this cash abroad, these companies are not subject to United States tax until the money is returned to America. These companies may be waiting for Congress to enact a tax holiday to allow the cash's repatriation.

Since Michael Kors is organized abroad, it never has to face this issue and will pay tax only on money earned in the United States. Right now, Michael Kors does not have significant foreign revenue, but this is bound to increase, as the company appears focused on building international sales.

Michael Kors will also be **able to dodge much of the securities and corporate regulation applicable to American public companies,** which are subject to scrutiny under the federal securities laws intended to protect investors. This requires an American company to file quarterly reports and publicly disclose material events promptly upon their occurrence. Executives also have to report all stock sales within two days, and companies are generally required to have a board comprising a majority of independent directors. As a foreign corporation, Michael Kors is under no such restrictions and instead is subject to bare-bones reporting requirements under United States securities law.

If a **shareholder wants to sue a Michael Kors director for misconduct, good luck. The corporate laws of the British Virgin Islands are very different from those of United States.** Michael Kors states in its I.P.O. prospectus that "minority shareholders will have limited or no recourse if they are dissatisfied with the conduct of our affairs." A shareholder would most likely have to sue in the British Virgin Islands. While a few weeks' visit there might be nice, I am not sure that shareholders are prepared to spend years on the island locked up in litigation.

It is not just Michael Kors that is taking advantage of **foreign incorporation.** Private equity firms have been buying American companies with significant foreign operations and reorganizing them as foreign corporations. The private equity firms will then arrange for the company to make an initial public offering on an American exchange. Freescale Semiconductor Holdings, a company purchased by a consortium of private equity firms in 2006, went public on the New York Stock Exchange in May, yet it was organized under the laws of Bermuda.

It is all seems so easy.

More American companies would probably love to lower their taxes and leave for the Caribbean, if not for Congress. In **2002,** Stanley Works, based in Connecticut, tried to reincorporate in Bermuda to save \$30 million a year in taxes. But after a public outcry, the company's board abandoned the plan. **Congress subsequently passed a law prohibiting companies from migrating out of the United States to lower their taxes unless the exit**

involved a sale of control. Private equity firms take advantage of this loophole to send portfolio companies with large overseas operations abroad.

Michael Kors was reincorporated in the British Virgin Islands and established its corporate headquarters in Hong Kong in connection with its acquisition by Sportswear Holdings in 2003. Sportswear Holdings is based in Hong Kong and controlled by Lawrence S. Stroll and Silas K. F. Chou, both of whom reside outside the United States. Michael Kors's foreign incorporation and headquarters was most likely put in place to take advantage of this foreign ownership and further ensure that the United States did not tax its owners.

Michael Kors and Freescale show yet again that American corporate tax laws need to change as companies become increasingly international. The United States is one of the few countries in the world to tax worldwide income for companies based here.

In a world where companies have a choice about where to incorporate, enforcing these tax rules is going to get harder. Michael Kors stock may be listed on the Hong Kong Stock Exchange and the company may have headquarters in Hong Kong, but this appears to be a mailbox. The fashion designer's largest office is in New York and its stock is also listed on the New York Stock Exchange. But when it came time to set up the company's place of organization, Michael Kors chose a third country where it had no operations.

Congress can try to close this loophole, but companies that want to lower their taxes will still find a way to incorporate abroad, something made easier by the ability to raise capital through an I.P.O. anywhere in the world.

Perhaps it is time for the United States to adopt a tax system more in line with the rest of the world. This does not mean pandering to tax havens, but it should incentivize companies to bring their riches to the United States.

The *regulatory concerns* are also high. American investors may be investing in Kors and other companies incorporated outside the United States without appreciating that they are not subject to the same United States laws that other publicly traded companies are. The Securities and Exchange Commission set up these different regimes to attract foreign listings, but companies like Michael Kors are taking advantage of the loophole to lower their tax burden, possibly at the expense of shareholders.

Welcome to globalization.

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