What's Up With SP 500 Companies Moving Overseas?

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The Standard Poor's 500 Index used to only include companies based in the United States. Now, 21 out of the 500 companies on the SP 500 are headquartered outside of the U.S. - and more are likely to follow... Exemplary of the trend is SP 500-listed Medtronic Inc. (NYSE:MDT). The world's fourth-largest medical device company announced June 15 it was buying competitor Covidien Plc. (NYSE:COV) - and a huge reason for the purchase was the way Covidien is set up... You see, Covidien is headquartered in Ireland, where the main corporate tax rate is 12.5% - well under the 35% tax rate that Medtronic and other U.S.-based companies face. Though Medtronic only paid a corporate tax rate of 18.4% in 2013 (it was able to avoid the 35% U.S. rate by keeping its international earnings abroad), its move to reincorporate in Ireland should help the firm lower its tax rate even further, and it will provide MDT more flexibility with its cash holdings.

And more and more companies are making this migration to reincorporate overseas to take advantage of foreign tax structures. According to Cato Institute research published in September 2012, the U.S. has the highest corporate tax rate among major industrial nations. Its effective tax rate of 35.6% on new corporate investment is nearly twice the average rate for the 90 countries studied. It used to be that reincorporating outside of the United States had negative consequences for SP 500 members, offsetting the tax benefit. Shifting headquarters abroad was grounds for dismissal from the index and was bad for a company's share price and shareholders. But that all changed in 2010...The SP 500's Decision to Include Companies That Move OverseasLarger and more diverse than the Dow Jones Industrial Average, the Standard and Poor's 500 Index is made up of 500 of the most widely traded common stocks in the United States. Their value equals about 70% of publicly traded stocks in the United States. The SP 500 is unique from other indices like the Dow and the Nasdaq because it's weighted so that each stock in the index is represented in proportion to its market capitalization. Because of this weighting methodology, and its diversity relative to other indices, it's likely the best representation of the U.S. stock market and economy. There are a few key criteria a company must meet to make the coveted 500. For instance, they are chosen for market size and liquidity - in other words, how easily an asset can be bought or sold on the market without affecting the asset's prices. But in 2010, one key element changed: domicile. The SP used to remove a company from its index if it left the United States. From 2002-2009, nine companies were taken off for reincorporating offshores. This removal was disadvantageous to the companies and their investors because exchange-traded funds (ETFs) tracking the SP 500 would have to dump shares, triggering a drop in share price. For instance, recently on March 27, Cliffs Natural Resources (NYSE: CLF) deflated 2.4% after it was booted from the SP 500 for market cap changes. And when news hit on Aug. 30, 2012, that Sears Holdings Corp.(Nasdaq: SHLD) would be cast out for falling below the public float threshold, shares dropped more than 8%.But in 2010, the SP decided to expand the domicile requirement. Now a company need only trade on a U.S. market, report its financial filings to the U.S. Securities Exchange Commission, report them in U.S. dollars, and have a majority of its business in the United States. The SP ultimately added back into its 500 eight of the nine companies kicked off from 2002-2009. According to The Washington Post, SP Index Committee Head David Blitzer said his firm was getting pressure from companies that had been removed, as well as from investors who wanted their ETF investments to include those companies. "We allow some flexibility," Blitzer said to Barron's in 2012. "We will list a company that we believe, and everyone else in the investment community believes, is a U.S. company, even though it's incorporated outside the U.S." Now that companies are no longer discouraged by the SP to relocate overseas, more choose to do so. And here's how that helps investors...How Investors Benefit When Companies Move AbroadAccording to a 2011 study by Ernst Young, in the 11 years since 2000, the United States had lost a total of 46 headquarters of Fortune Global 500 companies. Currently, a total of 21 companies in the SP 500 index are headquartered overseas.Note that with Monday's acquisition, Medtronic will soon shift its headquarters to Dublin, Ireland, pushing the total up to 22. More will surely follow. "Money always goes to where it's treated best," Money Morning Chief Investment Strategist Keith Fitz-Gerald said in reaction to the Medtronic-Covidien deal on Monday. "I can't blame these companies for going for lower tax rates. These are CEOs who are determined to do what maximizes profits for their shareholders - and rightly so, I might add." Fitz-Gerald has always recognized shifting wealth as an emerging opportunity. When high-flying, established companies like those on the SP 500 contemplate reincorporating to take advantage of a lower tax rate, it's a signal to investors that they are trying to get the most money to their bottom line and shareholders alike.So who's next? This year's notorious attempts by SP 500 company Pfizer Inc. (NYSE: PFE) to acquire British-based AstraZeneca Plc. (NYSE ADR: AZN) was in large part a move to reincorporate in the United Kingdom to ditch U.S. tax rates. The acquisition would have saved PFE - who currently pays a tax rate of roughly 27.4% - approximately $1 billion per year in taxes. Even though Pfizer's offers were rejected, the company will likely keep looking for a deal abroad that would make these tax savings a reality. In April, Chicago-based SP 500-lister Walgreen Co.'s (NYSE: WAG) Chief Executive Greg Wasson met in Paris with a hedge fund group to discuss a move to Switzerland to lower tax rates, according to BloombergBusinessweek. Maybe it's taking a cue from Alliance Boots, of which WAG owns a 45% stake and is set to acquire in full in 2015. Boots is the biggest pharmacy retailer in the UK. In 2008, it chose to shift headquarters from is founding place in Nottingham, England, to Zug, Switzerland. The move has saved it an estimated 100 million pounds ($167 million) in taxes per year, Bloomberg Businessweek reported.