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Billionaire Malone Gained Double Tax Break in Liberty Inversion

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Shifting the address of his Liberty Global Inc. from Colorado to London last year didn't just put billionaire John C. Malone in a position to reduce his company's tax bill.

He also took precautions to avoid the capital-gains hit that the so-called inversion would trigger for him and other investors. The day before the deal was announced, Malone — the company's chairman and controlling shareholder — transferred $600 million of his shares into a tax-exempt charitable trust. He avoided paying taxes on his remaining stake, worth about $260 million, by exploiting IRS regulations meant to block a different loophole.

All told, Malone escaped about $200 million in personal taxes, and Liberty Global's U.S. shareholders together likely saved more than a billion dollars, according to data compiled by Bloomberg.

"He's congenitally averse to paying taxes," said Robert Willens, an independent tax accounting analyst in New York City.

As the Obama administration attempts to implement anti-inversion rules announced in September, Liberty's strategies illustrate how billionaires and their companies find their way around tax regulations, and take advantage of unintended consequences.

Creative Tactics

Malone — whose net worth is $7.5 billion, according to the Bloomberg Billionaires Index — has a history of creative tax- avoidance tactics. Over the years, many of the 73-year-old media billionaire's biggest deals, such as buying the Atlanta Braves, have helped his companies to cut their tax bills.

Malone has at least four other charitable trusts, with more than $210 million in assets, IRS records show. Such trusts permit wealthy individuals to use the tax-exempt status of a charity to shelter income. In the past two years, he has also taken advantage of an Irish tax break to buy prime real estate in central Dublin.

Marcus Smith, a Liberty Global spokesman, declined to comment. He directed a request to interview Malone to Courtnee Ulrich, a spokeswoman at another of Malone's companies, Liberty Media Corp. She declined to answer questions and said Malone would not comment.

A Connecticut native, Malone runs his growing media empire from his adopted state of Colorado. He recently surpassed Ted Turner — a predecessor as owner of the Braves — as the largest private landowner in the U.S., according to The Land Report magazine. He owns about 2.2 million acres, including more than 5 percent of Maine's total land mass.

Fleece Wind Breaker

Often spotted in public in a fleece wind breaker, he owns Mosquito Island, off Maine's coastline, and at least two yachts — the 42-foot-long "Salty" and the 72-foot-long "Liberty," records show.

Malone, a Yale graduate with a doctorate in operations research from Johns Hopkins University, began his career doing research for the old Bell Labs. He built his reputation turning a tiny Denver cable company called Tele-Communications Inc. into the country's largest cable operator. He sold it to AT&T for $59 billion in 1999.

Malone and his three main companies — Liberty Media, Liberty Global and Liberty Interactive Corp. — have held stakes in a virtual Who's Who of big media, Internet and telecom businesses: News Corp., Viacom Inc., Time Warner Inc., QVC, Discovery Communications Inc., Court TV, DirecTV, Sirius XM Holdings Inc., Barnes & Noble Inc., and Expedia Inc.

Braves Deal

Since 1995, Malone has served as an unpaid director of the Washington-based libertarian think tank Cato Institute, which advocates for lower taxes. In his business life, Malone has put that anti-tax philosophy to work.

In 2006, for example, Liberty Media cashed out its stake in Time Warner without triggering a capital gains tax. Along with the $1.4 billion it got in cash from shedding the shares, Liberty also received ownership of the Atlanta Braves baseball team from Time Warner. Although the Braves were en route to their first losing season in 16 years, the move was worth it. Acquiring the team via a tax planning technique known as a "cash rich splitoff" entirely eliminated the company's tax bill on the deal.

The Braves, which Liberty Media still owns, broke ground in September on a stadium in the Atlanta suburbs, scheduled to be subsidized with more than $300 million of public funds.

Liberty Media later used a variation on the splitoff strategy when exiting its 19 percent stake in Rupert Murdoch's News Corp. Liberty Media swapped it for Murdoch's stake in DirecTV, again completely avoiding a capital gains tax.

Sirius Investment

In 2009, Liberty Media invested $530 million in money-losing satellite radio company Sirius XM. The main attraction: Sirius's $6 billion in tax losses, which could be used to offset taxes on Liberty's future profits. Sirius' stock, worth about a dime when Liberty made its investment, has risen to more than $3 since then.

The tale of Malone's inversion tax coup goes back to 2004, when Liberty Media spun off its overseas cable business into a separate U.S. company, tax-free. That company, eventually renamed Liberty Global, now has about 25 million cable, broadband and telephone customers in 14 countries, including Germany, Hungary, Belgium and Ireland. It provides those services under various brand names, including Unitymedia, UPC and Telenet.

Malone has served as chairman since then. He effectively controls the company by owning almost 87 percent of Liberty Global's super-voting B shares. That gives him about 30 percent of the company's total votes, the biggest voting bloc of any shareholder.

Virgin Media

By 2013, however, Liberty Global had a problem: if it wanted to tap into its offshore cash for some purposes, it could trigger a 35 percent corporate tax bill in the U.S., minus credits for income taxes paid overseas.

So, in February 2013, Liberty announced it would acquire Virgin Media Inc., a U.S. company with virtually all of its business in the U.K. The headquarters of Liberty Global Plc look across a small plaza at the upscale department store Harrods, in London's pricey Knightsbridge area. Since the deal was announced, Liberty Global's three classes of shares have risen, helping to add about $160 million to Malone's net worth.

The inversion can help Liberty Global gain access to offshore cash without generating a U.S. tax bill. Since the beginning of 2012, 14 U.S. companies have shifted their legal addresses to lower-tax jurisdictions overseas. Seven more have announced similar plans, including medical device maker Medtronic Inc. and Burger King Worldwide Inc.

Taxable Sale

Such companies are seeking to take advantage of the generous U.S. system of interest deductions for payments to their own affiliates abroad — benefits that are only available with a foreign parent company.

While lucrative for corporations, these inversions can have a drawback for their U.S. shareholders: they have to pay capital-gains tax on the transaction.

That's because, under 1994 U.S. Treasury Department regulations, exchanging the shares of the old company for the new one is treated like a taxable sale. It's as though a shareholder sold his stock and then used the proceeds to buy stock in the new company.

For many investors this tax bill is not a big issue. Large shareholders often include pension funds, 401(k)'s and other big institutions that don't owe taxes on their gains.

Two Steps

Not so for John Malone. In a typical inversion, he would have owed capital gains taxes at a rate of 23.8 percent on his stake worth about $860 million.

He took two steps to avoid this bill. The day before the deal was announced, he transferred about $600 million worth of his shares into the Malone LG 2013 Charitable Remainder Unitrust. Such trusts permit wealthy individuals to avoid tax by using the tax-exempt status of their favorite charity.

The use of such a vehicle by former Massachusetts governor Mitt Romney became controversial during his 2012 presidential campaign. Tax returns obtained by Bloomberg News through a Freedom of Information Act request showed that Romney would likely receive more in annuity payments from the trust than it would leave his chosen charity. A Romney spokesman said at the time that the trust "operated in accordance with the law."

Congress has tried to make these trusts less appealing, but they remain popular. Over the years, the IRS has challenged several similar moves on the eve of a taxable transaction, said Stephen Breitstone, head of the tax group at Meltzer, Lippe, Goldstein & Breitstone, LLP.

"The IRS has successfully challenged transactions that were done too late in the game," he said.

Way Around

Liberty Global also figured out a way around a tax bill for Malone's remaining stake, as well as for the rest of the company's U.S. investors. It used the government's own anti- abuse rules to its advantage.

U.S. companies are permitted to defer income taxes on profits attributed to foreign operations, until they bring home the cash generated by those earnings. Over the years, companies including International Business Machines Corp. and Hewlett-Packard Co. have used strategies to bring billions home yet avoid the tax.

In 2008, the Treasury Department cracked down on one such transaction, nicknamed the "Killer B" after a section of the tax code. Under the new regulations, the IRS checks if the transaction generates at least as much corporate income as the shareholders' potential gain. If it does, the transaction is not taxable for the investors under the anti-inversion rules, said Bret Wells, a tax law professor at the University of Houston.

No Tax

Guided by advisers at Shearman & Sterling LLP, Liberty Global took those new regulations and put them to work for a purpose the government never imagined. Liberty Global devised a transaction that would indeed generate income — but credited those profits to a newly created U.K. unit, not subject to U.S. tax. Because the income satisfied the U.S. government's test, investors weren't subject to any capital-gains tax. And since the U.K. has different tax rules, that particular income didn't generate any U.K. tax bill either.

The result was that Malone and his fellow shareholders didn't have to pay the tax bill that inversion would normally generate.

"Malone threw a multi-billion dollar left hook at the Treasury Department," said Samuel C. Thompson, a law professor at Pennsylvania State University. "They didn't see it coming."

The U.S. Treasury Department amended its rules in April to prevent a maneuver like Liberty Global's from happening again. However, it permitted the deal to stand.

Can't Challenge

Liberty Global "turned a provision that was supposed to be punitive into something they used for their benefit," said Willens, the independent accounting analyst. "When you do that, the IRS can't challenge it. How can the government disavow a provision it worked on for a long time?"

Meanwhile, Liberty Global's new U.K. parent company is taking steps to avoid the risk of incurring U.S. corporate taxes on cash from its foreign units. That's because such funds might have to pass through a U.S. subsidiary.

In a filing last April, Liberty Global disclosed that a U.S. subsidiary will pay at least $7 billion in tax deductible interest to its new U.K. parent over the next decade. Such payments are known to tax lawyers as "earnings stripping," because the big interest deductions strip profits out of the U.S., thus cutting any U.S. tax obligation.

Earnings Stripping

Earnings stripping is considered the most common way for inverted companies to cut their taxes. The Obama administration is working on proposals to limit it, according to a Sept. 22 Treasury Department notice. Democratic Senators Charles Schumer of New York and Richard Durbin of Illinois have introduced a bill to stop the practice.

Liberty Global's moves are just one facet of Malone's propensity for tax-free deals.

In the past two years, he has bought four properties in Ireland, which his ancestors left in the 1830s. They include an 8 million euro, 15 bedroom castle in Wicklow, about 90 minutes south of Dublin. He has also spent a combined 130 million euros ($163 million) to buy three of Dublin's most central hotels: the Westin, the Trinity Capital Hotel and the Hilton Dublin, according to CBRE Global Research and Consulting.

A tax break paved the way. In early 2012, Ireland introduced a capital gains tax holiday for investors buying Irish real estate who hold onto it for seven years.

In an interview last year, Malone talked about his motivations for buying the castle. He did not mention the break on Ireland's 33 percent capital gains tax.

“A combination of cheap money and a gloomy view of the future gives rise to opportunity for those who aren’t quite so gloomy,” he said.