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Harcourt, Cyanamid, Ethyl Contemplate Spins

by Robert W. Wood • San Francisco

It seems that virtually no issue of *The M&A Tax Report* goes by without some mention of the spinoff movement. This issue is no exception, with several spinoffs announced in recent weeks. What makes one of these transactions unique—despite all our focus on the all-important tax qualification under Section 355—is that it will deliberately be taxable.

Harcourt

Recently, Harcourt General Inc. announced a spinoff of its movie theater business. The company's plans call for the spinoff to occur in December, with current Harcourt shareholders receiving one share of the new company for every ten Harcourt common or Class B shares they hold. (See "Harcourt to Spin Off Theater Business, Creating Takeover Vehicle for Chairman," *Wall St. J.*, 9/16/93, p. A9.)

It is not clear from the published announcements just what the asserted business purpose might be, although one suspects that the bottom line is the enhancement of shareholder value. Indeed, the suggestion from Harcourt management is that the transaction will confer flexibility on both companies. But the spun-off company is expected to be an investment vehicle for the acquisition of other companies.

American Cyanamid

Another announcement concerns American Cyanamid, which is to spin off a majority interest in its Cytec Industries chemical business. The Cytec subsidiary was created last year, and the distribution of the stock is not a surprise. (See "American Cyanamid Plans to Spin Off Majority Stake in Its Chemical Business," *Wall St. J.*, 9/16/93, p. A5.)

However, unlike in the typical planned spinoff, here the distribution will be a taxable dividend to shareholders. The transaction will be taxable, because Cyanamid will hold preferred Cytec shares that will be convertible into 30% of the new company's common stock. Why would the preferred stock be retained? Presumably, because the parent anticipates that the distributed subsidiary will increase in value.

Perhaps this represents the ultimate in the spinoff craze—admitting taxable treatment. If these transactions have become so popular that even a taxable stock distribution is well-received, what can possibly be next?

Ethyl Corp.

Yet the tide is certainly not turning to taxable transactions. Ethyl Corp. just announced a spinoff of its chemical operations, representing

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$1.12 billion in assets. (See "Ethyl's $1.12 Billion of Chemical Assets To Be Spun Off Into New Company," *Wall St. J.*, 9/17/93, p. A3.) The transaction is only one of a series of chemical business spinoffs or sales that includes such notables as Texaco, Eastman Kodak, and, as previously discussed, American Cyanamid.

The touted benefits of the Ethyl transaction are familiar, and may not rise, in the Service's view, to the level of good business purpose: each company will be stronger after the spinoff, with management free to focus its strategies and resources on their respective core businesses.

Brooke Group Ltd.

Recently, Brooke Group Ltd. announced plans to spin off part of its SkyBox International unit to reduce its liability under its contingency value rights plan. The contingency value rights were issued to shareholders in a 1990 merger agreement, and at recent trading prices for Brooke Group stock (around $5 per share), could be worth a shopping $14 per share.

The idea behind designing the partial spinoff of the SkyBox operation as a dividend payment is to substantially reduce the company's liability to these rights holders. While the contingency value rights (traded separately on the New York Stock Exchange) were unchanged on the announcement, Brooke Group shares gained 47% on the announcement of the plan. (See "Brooke Group Plans to Spin Off Portion of Its SkyBox Unit," *Wall St. J.*, 9/13/93, p. B6.) ■