

New Round of Spins Suggests Pre-Eminence of Section 355

by Robert W. Wood

It is hardly a revelation that section 355 continues to be one of the most attractive provisions of Subchapter C. While the last several years have seen both legislative and administrative cutbacks on this venerable Code section, the desirability of the provision has only increased, particularly coupled with the economic and business climate that currently suggest divestiture and focusing on a core business rather than on the conglomeration that was the watchword of a past era. One recent spin candidate was described as "taking an ax to itself." ("Control Data Plans Spinoff of Its Computer Operations," *Wall Street Journal*, May 28, 1992, p. B-4).

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Keeping up with the spin-off craze can be dizzying. Current entrants into the spin-off field include Control Data corporation, that announced plans to spin off its computer operations to shareholders, converting the company primarily into a provider of services such as payroll processing and information management. The spun-off operations are to be known as Control Data Systems Inc. The remaining operations, currently in Control Data Corp., will be renamed Ceridian Corp. Analysts noted that the spinoff represents the logical conclusion to the last several years of divestitures by the company.

Though contingencies remain to the consummation of the deal, including shareholder approval, the business purposes for the spin include one which is on the Service's short list of approved business purposes. Silicon Graphics has signed a letter of intent to buy a 10% interest in Control Data Systems after the spin, and NEC Corp. may also purchase a 5% stake in the new company. Provided that the equity stakes are viewed as significant (which here they should be) and that they are coupled with statements that the investments would not be made if the new company were merely a subsidiary, the Service should have no problem about business purpose. Independently, the focus on key or core business, and the stock market reaction (which has already been favorable) makes it doubly arguable that this should be a no-brainer.

From Technology to Beer

Another entrant is Adolph Coors Co., which announced plans to spin off its non-beer business to shareholders. The ostensible purpose is to clear up confusion on Wall Street among both investors and analysts about Coors' operations. ("Coors to Spin Off Non-Beer Business In Bid to Clarify Company's Identity," Wall Street Journal, May 15, 1992, p. B-3.) If approved by shareholders and the Service, the spin would be pro-rata to shareholders. Judged by share prices, initial market reaction has been positive.

And Baked Goods

Another recent transaction was the announced spin by Ralston Purina Co. of its Continental Baking Co. unit. ("Ralston Purina Plans to Spin Off Big Baking Unit," Wall Street Journal, April 23, 1992, p. A4.) Continental would pay Ralston a special dividend of up to \$600 million. Among other approvals, Ralston is seeking a ruling as to the tax-free nature of the transaction.

Even analysts have wondered what advantage to Continental there would be from the transaction, since Ralston already functions largely as a stand-alone company. But Continental apparently expects that the spinoff will allow investors to focus more on the independent businesses, with higher perceived values individually than was previously perceived in the aggregate.

Other Deals

Optical Radiation announced plans to spin off its Consumer

Group in order that Optical Radiation can concentrate more closely on the development of emerging medical technologies. The pro rata division is contingent on advance Revenue Service approval as to the tax-free nature of the transaction. "Optical Radiation Plans to Spin Off Consumer Group," Wall Street Journal, March 18, 1992, p. B3.)

Pacific Telesis announced in April that it might spin off telephone operations valued at \$15 billion. Baxter International announced that it might spin off its home health care business. Ecolab announced that it might spin off (or sell) its Chemlawn unit. And spins involving Amoco (its Cyprus Minerals unit), Morton International's split from Thiokol, and Honeywell's spin of its defense business, have been viewed as generally positive.

Although virtually all spins are now viewed as a good deal for the company, and generally good for investors, this is not universally true. One analyst pointed to the spin of Indresco by Dresser Industries, and the spin of Uroplasty by Bioplasty, as avoidable investment opportunities. (See "Spate of Spinoffs Turns Investors' Heads," Wall Street Journal, May 12, 1992, p. C1.)

A Business Purpose For All Seasons

Although tax professionals have often toyed with the idea of proceeding with a significant spin without a ruling (for example, Quaker Oats' spin off of Fisher Price was almost done on the strength of an opinion before the Service finally issued a ruling), many have not had the intestinal fortitude to carry this off. And this is for good reason, since qualifying for a tax-free spin off depends on several subjective criteria.

But the opinion-in-lieu-of-ruling technique has been used recently by a variety of companies (Cabot Corp.'s spin off of Cabot Oil & Gas, Collins Foods International's spin of Collins Foods Inc., Honeywell, Inc.'s spin off of Alliant Techsystems, Tremont's spin of Baroid, Tyler Two and Tyler Three, and Dial Corp.'s spin of GFC Financial). In some of these cases, though, the transaction was a spin followed by a reorganization, which typically doesn't raise the same level of concerns present in spins that are not undertaken to facilitate a tax-free disposition of the subsidiary.

The business purpose for most of these core business or divestment situations seems clear: to enhance shareholder value. However, in order for a business purpose to support a private letter ruling, the Service requires that one or both of the corporations obtain a direct quantifiable benefit. Enhanced stock price would seem to be such a benefit, but this may not be the case where the corporation sells its stock to raise funds or uses its stock as consideration in an acquisition. In any case, the Service will not accept the "core business" business purpose (at least not by itself) in support of a ruling.

It remains to be seen whether the courts will take a similar view if and when the matter is litigated. Arguably they should. After all, one of corporate management's key indicia of success is the extent to which they can boost stock price (witness the widespread use of stock options and similar devices linking management compensation to stock prices).

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Given that enhanced stock value is such a universal corporate goal, it seems questionable that the Service would prevail if it challenged the tax-free nature of a spin-off which was motivated purely and plainly by the corporation's desire to enhance stock prices by concentrating on its core business. ■
