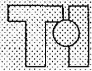
THE M&A TAX REPORT

The Monthly Review of Taxes, Trends & Techniques

Volume 3, Number 8 March 1995



TAX INSTITUTE

Editor-in-Chief

Robert W. Wood
Robert W. Wood, P.C.
San Francisco

Advisory Board

Gilbert D. Bloom
KPMG Peat Marwick
Washington

Louis S. Freeman
Sonnenschein, Nath & Rosenthal
Chicago

Elliot G. Freier
Irell & Manella
Los Angeles

Lawrence B. Gibbs
Miller & Chevalier
Washington

Steven K. Matthias
Deloitte & Touche
San Francisco

Matthew A. Rosen
Skadden, Arps, Slate, Meagher & Flom
New York

Irving Salem
Latham & Watkins
New York

Joseph L. Schiffhouer
Federal Express Corp.
Memphis

Mark J. Silverman
Steptoe & Johnson
Washington

Robert Willens
Lehman Brothers
New York

No Loss for Seagram on Conoco/DuPont Stock Swap

by Robert W. Wood • San Francisco

In a decision that some feel will have far-reaching implications, the Tax Court in *J.E. Seagram Corp. v. Commissioner*, 104 T.C. No. 4 (1995), decided that a transaction that was undertaken in two steps, culminating in DuPont's acquisition of Conoco qualified as a reorganization. Consequently, said the Tax Court, no loss on the transaction could be recognized.

Continued on Page 3

ALSO IN THIS ISSUE:

- Built-in Gains Regulations Finalized 4
- Book Review: M&A Tome Answers Many Questions 6
- Should Corporations Adopt Periodic Buyback Plans? 8

NO LOSS FOR SEAGRAM Continued from Page 1

Not too many tax decisions get written up in the Wall Street Journal. This one did. *See* "Tax Court Ruling on *Seagram* Voids Threat to Mergers," Wall Street Journal, Jan. 26, 1995, p. B5. The Wall Street Journal suggests that despite the fact that the Tax Court's decision will force Seagram to take a $65,000,000 charge against earnings, it will eliminate a threat to the popular tax-free stock swap. Indeed, *M&A Tax Report* board member Robert Willens is quoted by the Journal as saying that if Seagram's position had been upheld in the case, it would have been much more difficult for a publicly traded corporation to do a tax-free merger. *Id.*

DuPont/Conoco Deal

The case arose out of Conoco's acquisition of DuPont. J.E. Seagram Corp. ("Seagram") was the successor to Joseph E. Seagram & Sons, itself a subsidiary of the Canadian parent, The Seagram Company Ltd. The Seagram sub purchased 143,800 shares of Conoco on the New York Stock Exchange, and then initiated a tender offer to purchase up to 35,000,000 shares (a total of 40.76%) of Conoco.

Conoco then entered into an agreement with DuPont Holdings, Inc., a subsidiary of E.I. DuPont de Nemours & Company, under which DuPont Holdings commenced a competing tender offer for Conoco. DuPont Holdings offered cash and DuPont stock for the Conoco stock. The agreement between Conoco and DuPont Holdings called for Conoco to be merged into DuPont holdings if DuPont Holdings acquired more than 50% of the Conoco stock.

When the smoke cleared, the Seagram sub had acquired approximately 32% of the Conoco stock, while DuPont Holdings had acquired in excess of 50% of the Conoco stock. Consequently, the Seagram sub tendered its Conoco stock in exchange for DuPont stock. Conoco then merged into DuPont Holdings. Immediately thereafter, the Seagram sub owned 20% of the outstanding stock of DuPont.

Who's On First?

DuPont treated the tender offer and merger as a reorganization, filing its 1981 return accordingly. DuPont and Conoco advised former Conoco shareholders who had exchanged their stock for DuPont stock (in either the exchange portion of the tender offer or the merger) that they had no taxable gain or loss. When the Conoco/DuPont merger was complete, approximately 78% of the Conoco stock had changed hands for cash under one of the two tender offers. However, approximately 54% of the Conoco equity remained in corporate solution in the form of DuPont shares received in exchange for Conoco shares.

Seagram did not report a loss for financial accounting purposes as a result of its exchange of Conoco stock for DuPont stock. However, Seagram did claim a $530,400,000 short-term capital loss on the exchange of the Conoco stock for the DuPont stock. The IRS disallowed the loss, determining that the exchange qualified as a reorganization under Section 368(a)(1)(A).

Tax Court Enforces Reorganization Treatment

Seagram argued in Tax Court that the exchange of

Continued on Page 4

NO LOSS FOR SEAGRAM Continued from Page 3

the shares was not pursuant to a "plan of reorganization" as contemplated by Section 354(a)(1). However, the Tax Court viewed the acquisition of Conoco as a two-step deal under Section 368(a)(1)(A) and 368(a)(2)(D). The merger of Conoco and DuPont Holdings, said the Court, qualified under state law, thus meeting the statutory merger requirement of Section 368(a)(1)(A). Indeed, the Tax Court noted that the exchange of DuPont common for Conoco common fell under the provisions of Section 368(a)(2)(D).

The Tax Court specifically rejected Seagram's argument that the exchange of Conoco stock for DuPont stock under the tender offer, rather than pursuant to the merger, could not have been in pursuance of a plan of reorganization. While contingencies may have existed that would have resulted in the failure of the merger to go forward, the Court reasoned, the merger still took place. The Court was unwilling to find that the contingent nature of the transaction was of any particular moment. Taxation, said the Court, "depends on actual events, not on what might have happened."

Plan? What Plan?

Some taxpayers who have found themselves arguing that there really *was* a plan of reorganization may be comforted by the Tax Court's comments about the plan of reorganization requirement. The Court suggested the requirement was one of "substantial elasticity." The agreement between DuPont and Conoco, said the Court, had a discreet beginning, a clear end, and apparently nothing that would suggest an invalidation of the contemplated reorganization.

Students of tax-free reorganizations may doubtless think of other reasons why the transaction would have failed. Seagram argued, for example, that there was a failure to meet the continuity of interest requirement. Indeed, DuPont acquired approximately 54% of Conoco's stock in exchange for DuPont stock (this included Seagram's Conoco stock which was tendered under DuPont's tender offer). However, the Tax Court found the continuity of interest requirement met and thus rejected this argument.

Last Word

It may be that the *Seagram* decision—while doubtless loathsome to Seagram—may be seen as an important validation of the stock swap. On the other hand, at least a few practitioners have viewed the case as distinguishable, and thus as not sounding the death knell of the stock swap. Still, it is hard to argue this point too much, when the Tax Court commented in the *Seagram* opinion that if it ruled in Seagram's favor it would be "eliminating the possibility of a tax-free reorganization of any company whose stock is actively traded." ■

ALSO AVAILABLE FROM TAX INSTITUTE:

Taxation of Damage Awards & Settlement Payments, by Robert W. Wood

The Manual of California Taxes, by Kathleen K. Wright and Richard J. Ayoob

Tax Guide for Church & Clergy, by Mark A. Muntean

The Home Office Tax Guide, by Robert W. Wood

For more information, call or write today:

TAX INSTITUTE
P.O. Box 192026
San Francisco, CA 94119
(800) 852-5515 Fax (415) 566-7310