Poison Pill Redux

By Robert W. Wood • San Francisco

Every few years, I point out my surprise that poison pill plans are not often considered in the tax law. This seems an appropriate time to do that again, since poison pills were very much in the news in the case of PeopleSoft and Oracle; in fact, it is not every day that you read about poison pills and see pictures accompanying a poison pill story in the WALL STREET JOURNAL and THE ECONOMIST.

Leo Strine, one of the Delaware Chancery Courts' four Vice-Chancellors, was quoted in the WALL STREET JOURNAL about poison pills and in THE ECONOMIST the same week. His picture appeared in both publications. *See* Bank, *How a Judge's Ruling May Curb "Poison Pill" As Takeover Defense,* WALL ST. J., Dec. 13, 2004, at B1; *The Case of the Poison Pill,* THE ECONOMIST, Dec. 11, 2004, at 64. Perhaps this is not sexy stuff outside the rather circumscribed rule of the takeover defense. But this has been one of the supposed proving grounds of the poison pill.

Apart from Mr. Strine's role in the Oracle/PeopleSoft case, Strine also has written about poison pills, advocating enhanced choice for shareholders.

Taxation

All this, I suppose, has little to do with taxation. The tax status of poison pill plans was much debated until Rev. Rul. 90-11, 1990-1 CB 10. There, the IRS ruled that contingent rights awarded under poison pill plans do not create income. The typical poison pill plan awards rights to existing shareholders that are contingent upon a tender offer or acquisition. Under the facts there present, the ruling finds that the rights awarded to shareholders are not income. Furthermore, the ruling concluded that a plan of this nature does not constitute an option for purposes of Code Sec. 382.

Rev. Rul. 90-11 does not address poison pill plans in general, but only the specific plan considered in the ruling. The test for whether a pill plan will have no tax effects (as indicated in Rev. Rul. 90-11) is whether the rights in the plan at issue are "similar" to those in the plan described in Rev. Rul. 90-11. Rights are "similar" if the principal purpose for adopting the plan is to establish a mechanism by which a publicly held corporation can provide shareholders with rights to purchase stock at substantially less than fair-market value as a means of responding to unsolicited offers to acquire the corporation.

It should typically be easy to establish that the principal purpose of a plan is to provide rights to public shareholders to buy stock at a discount, as a means of defeating the hostile bidder. However, in determining that the adoption of the poison pill plan will not constitute a distribution, exchange or other taxable event to the company or its shareholders, Rev. Rul. 90-11 does not address the need for similarity to the model plan described in the ruling.

There will probably always be new defensive measures created, and ultimately some will be tested in the courts. What seems odd is that there has been virtually no discussion in the professional literature about the tax treatment of pill plans, apart from the initial wave of interest in the wake of Rev. Rul. 90-11. In the meantime, tax advisors should give at least some thought to the tax impact of pill plans, even though pill plans are virtually always adopted (or amended) on the cusp of a takeover battle.

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