

Taxes and Poison Pill Swan Song?

By Robert W. Wood • San Francisco

Given the prevalence of poison pills as a takeover defense in corporate America, I have always been surprised that their tax effects are infrequently considered. The tax effects are usually inconsequential, though interpretive

questions remain. Poison pill plans have been a staple of corporate structure for nearly 30 years. They are one of the most widely used—and most effective—tools in a company's arsenal to ward off hostile takeovers.

History Channel

Corporate history fans date the poison pill to 1985 when Wachtell, Lipton, Rosen & Katz was first successful in court in defending the *bona fides* of the pill. It served a legitimate corporate purpose, said the court, and the rest is history. That was two years before Oliver Stone's first WALL STREET movie classic, recently reprised.

But unlike Gordon Gekko, the days of the poison pill may not last forever. In fact, the poison pill has come under attack and is at risk in a court battle. The question arises on the battlefield for control of Airgas, Inc., an industrial gas company. Once again, Wachtell, Lipton, Rosen & Katz is defending the poison pill, hoping that its reprise of its day in court defending poison pills is better than Gordon Gekko's second trip to the movie theater.

It may be hyperbole to suggest that a decision from a Delaware court may actually sound the death knell of the poison pill plan. Yet more than a few observers have characterized the decision as that important. [See Gina Chon and Anupreeta Das, *Takeover War Turns In to a Trial Over "Poison Pill,"* WALL ST. J., Jan. 18, 2011, at C1.

The pending case concerns Air Products & Chemicals Inc.'s hostile attempt to gain control of Airgas, Inc., a rival industrial gas company. The deal has been hanging fire for a year and is now valued at \$5.9 billion. Delaware Chancery Court Judge William Chandler faces the decision whether to end Airgas' poison pill.

The question raises a larger arc of concern: the point at which power and responsibility should shift from the board to shareholders in a takeover offer. With a year-long batter over Airgas, and a staggered board of directors, the poison pill has a pivotal role in defense. It may be seen as making it too tough to acquire control of *anyone*.

Taxing Pills?

The tax status of poison pill plans was addressed in 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 presented in the ruling, the IRS found that when these rights were awarded to shareholders, they did not constitute income. Furthermore, the ruling concluded that a plan of this nature does not constitute an option for purposes of Internal Revenue Code Section ("Code Sec.") 382. Of course, Rev. Rul. 90-11 does not address poison pill plans in general. Undeniably, there are variations in such plans.

The test for whether a pill plan will be considered to have no tax effects (as indicated in Rev. Rul. 90-11), seems straightforward. Are the rights provided under the plan being examined "similar" to those in the plan described in Rev. Rul. 90-11? If they are, there should be no income to right recipients. If not, it isn't so clear.

Similarity Defined?

Rights are "similar" to those set out in the ruling based on their purpose. Examine whether the principal purpose sought by adopting the plan is to establish a mechanism by which a publicly held corporation provides 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. That, in can probably be said, is the purpose sought by virtually *every* poison pill plan.

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.