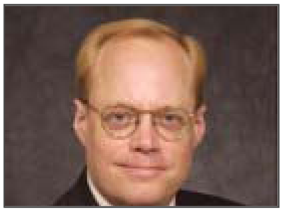
Forbes



Robert W. Wood

THE TAX LAWYER

TAXES 1/27/2015

Yahoo Reveals Tax Savvy Alibaba Spinoff Plans

Updated. The wait is over, not only for the Yahoo! Inc. earnings reveal, but also for its big 'sale' plans for its holding in Alibaba Group Holding Ltd. CEO Marissa Mayer plans a nice non-taxable spinoff that should help investors take a breath. The new company will own all of Yahoo's remaining shares of Alibaba (15%), which are valued at $40 billion.

It will assume no debt in the deal, and Yahoo will retain its cash. Notably, Yahoo will keep its 35.5% interest in Yahoo Japan too, worth about $2.3 billion. Starboard Value LP has pressured Yahoo to minimize taxes, though it is not yet clear if this move does it all.

Investors expect not only earnings but a nice non-taxable bump on Yahoo's roughly $40 billion stake in Alibaba Group Holding Ltd. Yahoo should keep some of Ma's company, but cashing in on even part of Yahoo's shrewd 2005 investment in Alibaba could mean paying the IRS 35%, right? Recall that Yahoo took a $3 billion tax hit when it sold about $10 billion in Alibaba shares.

But that was then. More than 18 months ago, Yahoo CFO Ken Goldman complained about U.S. taxes on Yahoo's 2012 $7.6 billion sale of half of its 40% stake in Alibaba. Even then, the goal was far more tax-efficiency. And the calls for improvement have grown to a virtual clamor. As Yahoo announces earnings, the timing for a tax coup is important. For this next batch of sales, Yahoo is expected to be–more tax savvy.

Yahoo probably will retain stock, not just to avoid an IRS bill of up to $14 billion. Buffett-like, Yahoo should 'sell' in a way that postpones U.S. taxes. One suggestion was to emulate John Malone's Liberty Ventures disposition of travel website TripAdvisor Inc. Liberty created a new unit that borrowed $400 million from banks, so Liberty wound up with most of the cash. Meantime, the new unit's stock was spun off to Liberty shareholders.

TripAdvisor then acquired the new unit in exchange for the travel site's stock. TripAdvisor was left to repay the $400 million, while Liberty Ventures (along with the cash) could exit TripAdvisor. Talk about a sale without the tax aftertaste. Similarly, Yahoo could choose to spin off its Alibaba stock into a new entity. The Newco would borrow money and distribute cash to Yahoo.

Another flavor of the tax dance would be a cash-rich division, like one orchestrated by Berkshire Hathaway Inc. and Graham Holdings Co. Buffett's company unloads its stake in the former Washington Post Co. without the bitter tax aftertaste. Graham transfers cash (and a Miami television business) into a new subsidiary. Graham then shifts stock in that new unit to Berkshire Hathaway, which moves its Graham stake back to the media company.

Isn’t this really Berkshire Hathaway selling its stake in Graham for cash and a TV station? Sort of, but better without taxes. Yahoo might try it, exchanging Alibaba shares for shares in a new unit holding cash. Alibaba would need to shed some assets too, but the stakes should make it worthwhile. Alibaba dominates many businesses in China, with $8.5 billion in sales and $3.8 billion in net income for its year ended in March 2014.

Jack Ma started the company in 1999 in his apartment in Hangzhou, China. Although Alibaba went public on the NYSE, Alibaba.com went public in Hong Kong in 2007, going private again in 2012. But this time its U.S. IPO looks different. And it may even out-Amazon Amazon and eBay, with tax as well as non-tax advantages. Alibaba is a Cayman Islands company, yet derives most of its revenue in China. Some licenses and Internet operations are held in separate entities.

Alibaba brings together thousands of merchants who join a network, providing a platform to showcase products those merchants provide. In effect, Alibaba brings the world and China together. Its model is revenue sharing, not listing, and the larger the network, the greater the shared benefits. Alibaba’s offering materials said its operating companies get favorable tax treatment in China.

Qualified high and new technology businesses can pay only 15%, and some software companies pay 10%. There are also tax holidays for qualified software enterprises, with a two-year tax exemption commencing when the company first becomes profitable, and a 50% tax cut for three years thereafter. Yahoo could be learning from the best.

For alerts to future tax articles, follow me on Forbes.com. Email me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.