Weil partners Joseph Pari, Devon Bodoh and Graham Magill presented on "Spin-offs in the Current Uncertain Environment," Part I of a three-part mini-series focused on spin-offs within Weil's 2021 Tax Webinar Series.

Key Takeaways

I. Introduction

The panel discussed spin-off transactions and how spin-offs are being used today. Devon Bodoh described the importance of spin-off transactions as one of the few remaining transactions that allow a corporation to move assets out of corporate solution without paying double tax, thereby maximizing corporate value.

Mr. Bodoh went on to note important considerations for companies to position themselves appropriately both during the COVID-19 era and after (e.g., whether certain businesses should be separated because of risk, fit and focus or otherwise).

II. Spin-off Basics

Next, Graham Magill provided a broad overview of the significant number of requirements that need to be met to qualify as tax-free and emphasized the importance of understanding these requirements. For example, meeting the distribution of control requirement under Section 368(c) of the Code can lead to opportunities through the use of a high-vote/low-vote structure, which can afford additional monetization benefits while preserving the ability to engaging in a tax-free spin-off.

Mr. Bodoh and Ms. Magill also discussed the recent market trend towards foregoing an IRS private letter ruling in favor of relying exclusively on an opinion from tax counsel.

In addition to noting the valid business purpose requirement for a spin-off to receive tax-free treatment, Ms. Magill highlighted corporate reasons why businesses decide to engage in a spin-off transaction. The panel noted that, based on experience, the most common business purpose is often "fit and focus" and that shareholder activists are often recognized as being a catalyst for spin-off activity.

III. Leveraged-Spin Offs

Next, Joseph Pari highlighted the importance of establishing an appropriate capital structure in every spin-off transaction and discussed the different ways to leverage the controlled corporation by walking through a variety of different fact patterns (i.e., debt for debt exchange, debt for equity exchange and reverse spin-off). Although these transactions may yield economically equivalent results, Mr. Pari emphasized that the tax consequences may differ.

While the variations are plentiful, one common way is through a debt for debt exchange with the controlled corporation generally being a newly formed entity. In discussing debt for debt exchanges, Mr. Pari provided insight on the complexities that are often encountered in connection with a spin-off (e.g., restructuring to either move the assets into a single controlled corporation or to move multiple corporations under a single controlled corporation).

Mr. Pari also discussed another common strategy to monetize the controlled corporation through a debt for equity exchange and noted that a popular technique is through a high-vote/low-vote structure. Finally, in addition to engaging in a debt for debt and debt for equity exchange, Mr. Pari also noted a third strategy, a reverse spin-off, which allows a corporation to extract value from the controlled corporation in excess of the distributing corporation's basis in the controlled corporation, tax-free.

In Part II, the panel will discuss Reverse Morris Trust transactions, which are frequently used in connection with leveraged spin-offs.