

Session 18 - Corporate Reorganizations

- ▶ Why reorganize?
- ▶ Do I acquire stock or assets?
- ▶ Is the transaction taxable or tax-deferred



Reasons for reorganizations

- ▶ Improve economic efficiency
 - Vertical or horizontal integration
 - Economies of scale and / or scope
 - Exploit asymmetric information
 - Enter new lines of business (diversify)
 - Exit business
- ▶ Extend managerial power
- ▶ Transfer wealth



Nontax issues

- ▶ Financial reporting effects
- ▶ Transaction costs
- ▶ Contingent liabilities
- ▶ Control issues
- ▶ Political / regulatory costs
- ▶ What consideration do I have to offer?



Tax issues

▶ Seller

- Will a tax be owed by selling firm?
- Will tax be owed by selling firm's shareholders?

▶ Buyer

- What will the basis in the target's assets be?
- What will happen to the tax attributes of the target?

▶ Both

- What effect will the financing choice have?



Key IRC sections

- ▶ §368 Definitions related to corporate reorganizations
 - Specifically §368(a)(1)(A) - 368(a)(1)(G)
- ▶ §336 Gain or loss recognized on property distributed in complete liquidation
- ▶ §338 Certain stock purchases treated as asset acquisitions
 - Especially §338(h)(10), Elective recognition of gain or loss
- ▶ §355 Distribution of stock and securities of a controlled corporation



Acquisitive reorganizations

- ▶ Transactions in which one corporation acquires assets or stock of another
- ▶ Types
 - A - statutory mergers or consolidations
 - B - acquisitions of stock of target for voting stock of the acquiring corporation
 - C - acquisitions of assets of target for voting stock of the acquiring corporation



Other reorganizations

▶ Divisive reorganizations

- Result in the division of a single corporation into two or more separate entities (often preceded by a D reorg)

▶ Nonacquisitive, nondivisive reorganizations

- Adjustments to the corporate structure of a single, continuing, corporate enterprise
 - Recapitalization (E)
 - Change in identity, form, or place of incorporation (F)
 - Certain transfers of substantially all assets from one corporation to another, followed by liquidation of the first corporation (nondivisive D)
 - Transfers of a corporation's assets to another pursuant to a bankruptcy reorganization plan (G)



Acquisition tax options

Taxable asset
acquisition

Taxable stock
acquisition

Tax-deferred asset
acquisition
(Type A or C reorg)

Tax-deferred stock
acquisition
(Type B reorg)



Some basic concepts

	Taxable	Nontaxable
(1) Seller taxed on gain?	YES	NO
(2) Buyer gets stepped-up basis?	YES	NO
(3) Buyer typically pays with:	CASH	STOCK



Assets or stock?

- ▶ Why only buy the assets of a corporation? The stock?
 - What are the consequences of each?
 - Does 100% of equity = 100% of assets?
- ▶ What are the non-tax issues?
- ▶ Who is potentially liable for tax?
- ▶ What determines the amount of the tax?



Overview of Taxable Acquisitions

- ▶ Taxable asset acquisitions are a potential alternative (or necessary) in a number of situations:
- ▶ Non-tax reasons:
 - T may be an unincorporated division of the seller or T may be a sole proprietorship, partnership, LLP or LLC
 - T may have “liabilities” that the acquiring corporation wishes to avoid



Overview of Taxable Acquisitions - continued

► Tax reasons:

- T may have NOLs that can be used to shelter the gain on the sale of its assets
- T may be a member of a consolidated group that has NOLs that can be used to shelter the gain on T's asset sale



Tax-free acquisitions

▶ General tests

- Must have a business purpose; will not qualify if it is undertaken solely for tax avoidance

▶ Continuity of business

- After the reorganization the acquirer either uses a significant portion of target's assets or continues a significant line of the target's business.

▶ Continuity of shareholder interest

- Material part of the consideration received by target shareholder consist of stock of the acquirer



Divestitures

- ▶ What motivates a divestiture?
 - Better management of units
 - Market valuation of individual activities
 - Isolation of certain activities
- ▶ Types
 - Sale of subsidiary
 - Tax-free divestiture
- ▶ Tax consequences
 - Subsidiary sale may be taxable or tax free

