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

<table>
<thead>
<tr>
<th>Taxable asset acquisition</th>
<th>Taxable stock acquisition</th>
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</thead>
<tbody>
<tr>
<td>Tax-deferred asset acquisition (Type A or C reorg)</td>
<td>Tax-deferred stock acquisition (Type B reorg)</td>
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# Some basic concepts

<table>
<thead>
<tr>
<th></th>
<th>Taxable</th>
<th>Nontaxable</th>
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</thead>
<tbody>
<tr>
<td>(1) Seller taxed on gain?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>(2) Buyer gets stepped-up basis?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>(3) Buyer typically pays with:</td>
<td>CASH</td>
<td>STOCK</td>
</tr>
</tbody>
</table>
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