Is Target Stock Really an Alternative to a Spinoff?

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Over the last eight or nine years, companies considering a tax-free spinoff under Section 355 have worried that the IRS will be less amenable to issuing a favorable ruling on the transaction than in the old days. Among the many concerns facing

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significant when it comes to voting power: Liberty A shares are to have only one vote per share, while Liberty B shares are accorded ten votes per share. *Id.*

Tax Worries

For anyone who has had to justify a business purpose to wheedle an advance ruling out of the IRS on a spinoff recently, the major concern in all of this should probably be all of the (outlandish?) statements made by companies, underwriters and analysts about just why the tracking stock gets issued in the first place. TCI, for example, states that its hopefully soon to be issued Liberty tracking stock is designed to correct investor perceptions of value. By making Liberty a separately traded security, the argument goes, investors should find Liberty's business easier to analyze. The price of the two stocks when added together will reach a higher figure than the regular old TCI shares do now. See "TCI Holders React Coolly to Stock Plan," *Wall Street Journal,* April 20, 1995, page C1.

Admittedly, this kind of theory sounds awfully like the reason companies often give for a corporate separation under Section 355. To be sure, creative tax practitioners will doubtless still have arguments why Section 355 is the only route to success. Although some analysts may give a wholesale endorsement to the viability of particular target stock issuances, some others conclude that target stocks do not perform as well as spinoffs.

Target stocks may trade at a discount compared with what would be their truly independent values. After all, target stock shareholders will by definition have fewer rights (and no claims on the company's assets) as compared with shareholders of a newly independent spun-off entity. Indeed, at least as far as spinoffs are concerned, market data does suggest that the often-touted benefits of a spinoff (the separate pieces are worth more separated than as a single whole) may in fact be true. See "Target Stock is Under Fire from Investors," *Wall Street Journal,* April 11, 1995, page C1.

Ultimately, some of the notable failures in the target stock venue may prove to be the best arguments for tax practitioners who are confronted by a "why don't you do it this way?" argument from the IRS. As noted at the outset, KMart and RJR Nabisco Holdings fumbled their target stock issuances. KMart's experience was particularly negative, replete with acrimonious voting by shareholders and negative press.

Also, RJR Nabisco failed in its offering of target stock when many investors expressed a preference for a true split off of the food from tobacco businesses. One of the main objections to the target plan was simply that under it, the food business would not be truly separated from the tobacco business, the latter bearing the risks of potentially huge liabilities. Ultimately, of course, RJR made an initial public offering of its Nabisco shares. See "Target Stock is Under Fire from Investors," *Wall Street Journal,* April 11, 1995, page C1.

On the topic of tobacco industry spinoffs, by the way, the most recent entrant is Kimberly-Clark, which announced a spin off of its cigarette paper and tobacco operations in the face of liability fears. See "Kimberly-Clark To Spin Off Tobacco Unit," *Wall Street Journal,* May 10, 1995, p. A3.

Conclusion

It is probably too soon to signal either the success or the death knell of target stock. Ironically, the more successful and prevalent target stock issuances become, the more likely that companies and their tax advisors will have the target stock alternative suggested to them by the IRS in the face of a desired spinoff. Ultimately, this should simply not be a problem, because both legally and structurally, a spinoff is an entirely different transaction.

Yet the closer one tries to come in a financing model to a spinoff, and the more such sublimations are touted by analysts and issuers as the answer of the 90's, the more one wonders whether there may eventually be even more difficulty in achieving a Section 355 transaction than we have all come to expect. ■