Morris Trust and More

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For practitioners interested in current and recurring issues in the M&A world (who isn't?), the recent ALI-ABA Corporate Mergers and Acquisitions program held in New York City and streamed *via* live Web cast served as an outstanding review. The program included a diverse discussion of issues that may affect different deals. Topics ranging from employee benefits and executive compensation to intellectual property and antitrust issues were all addressed during this two-day program.

Tax professionals would be well advised to attend or view this panel solely to hear Lewis Steinberg's review of tax considerations in structuring and negotiating acquisitions. While ostensibly billed as a review for the "nontax specialist," even the most sophisticated practitioners will find Steinberg's discussion enlightening and his thorough outline helpful. Among his other nuggets of wisdom, Steinberg provides a review of tax-free spin-offs under Internal Revenue Code Section ("Code Sec.") 355.

Recall that Code Sec. 355 allows for tax-free distributions of a corporate subsidiary's stock, provided the parent owns 80 percent or more. This is true at both the corporate parent level as well as the shareholder level. Steinberg's materials demonstrate that tax-free spin-offs (as well as split-offs and split-ups) are effective planning tools. Say a corporation wants to separate a regulated business from a nonregulated business? How about slicing off a fast-growing capital intensive business from a slower-growing cash generating business?

After revisiting the requirements, tricks and traps of Code Sec. 355 treatment, Steinberg addressed the acquisition technique branded the "Morris Trust" transaction. Like Voltaire's deconstruction of the true character of the Holy Roman Empire (it was not holy, Roman or an empire), Steinberg's analysis of the Morris Trust transaction helps dispel the misapprehension that an *actual* trust is involved. Rather, the title refers to a case, *Mary Archer W. Morris Trust*, CA-4, 66-2 USTC ¶9718, 367 F2d 794 (1966) in which the Fourth Circuit approved the use such a technique.

Morris' Vehicle

Let's say a buyer wishes to acquire a target corporation, but not certain assets of the target. The Morris Trust transaction can handle this just fine. Just combine a Code Sec. 355 spin-off with a tax-free "A" or "B" reorganization.

First, the target and the acquiring corporation decide which assets the acquiring corporation seeks. The target corporation then forms a new subsidiary, dropping the unwanted assets into the subsidiary. Then it spins off the subsidiary by distributing the subsidiary's stock *pro rata* to the target shareholders pursuant to Code Sec. 355.

The parent/target now has only the desired assets. That parent/target then merges into the acquirer in an "A" or "B" reorg, with the target shareholders receiving more than 50 percent by vote and value of the acquirer. The key, according to Steinberg, is to observe the requirements of Code Sec. 355.

Among other things, that means that the consideration used in the acquisition of the parent/target must generally consist of solely stock. The historical shareholders of the parent/target must receive more than 50 percent of the acquiring company's stock.

Furthermore, the second (acquisition) step in the transaction normally cannot involve a C reorg, a forward triangular merger or a reverse triangular merger. After all, each of these tax-free reorgs involves the acquirer obtaining "substantially all" the assets of the target. With the Morris Trust transaction, the whole point is to isolate the particular assets the acquirer wants through a prior spin-off of the unwanted assets.

Significantly, the IRS does now allow these types of reorgs as the second step in a "Reverse Morris Trust" transaction. [*See* Rev. Rul. 2003-79, IRB 2003-29, 80 (July 1, 2003). In a reverse Morris Trust transaction, the desired assets are spun off as the first step.] Thus, there's plenty left in Mrs. Morris' cupboard worth trying.

While the use of the Morris Trust transaction is just one of the countless tidbits in Steinberg's materials and the whole ALI-ABA Corporate Mergers and Acquisitions program generally, it demonstrates the detailed analysis available to practitioners if they dig down into the materials provided. M&A attorneys—and particularly tax attorneys engaged in M&A transactions—should take the time to watch these presentations and peruse the materials provided. To purchase an online version of this course or for information about other ALI-ABA courses and live events, go to *www.aliaba.org* or call (800) 253-6397.

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