Poison Pills Newsworthy Again

by Robert W. Wood • San Francisco

Poison pill plans are in the news again, with plans being adopted by Circus Circus in an attempt to fend off the unwelcome Bally Entertainment, and by Unitrin, Inc., in rejecting American General Corp. Unitrin's poison pill plan would be triggered if one party acquired more than 15% of its stock without the board's permission. In that case, all other shareholders would be entitled to buy—at half price—stock in either Unitrin, or whatever company acquires it. (See "Unitrin Erects Defenses to Halt Takeover Bid," *Wall St. J.*, 8/5/94, p. A6.)

In the case of Circus Circus, the defensive plan includes a dividend distribution in the form of a stock purchase right for each common share outstanding. The right entitles holders to buy one new share of common stock at an exercise price of $125. The rights will be exercisable if a party

Continued on Page 8

POISON PILLS Continued from Page 6

acquires or announces a tender offer for 10% or more of Circus Circus's common stock. If a party acquires that proportion of stock, each right will entitle the holder to buy, at the regular exercise price, Circus Circus common shares having a total market value of twice the exercise price. (See "Circus Circus Erects Takeover Defenses As Bally Shows Interest in Combination," *Wall St. J.*, 7/15/94, p. C15.)

For example, if Circus stock were to sell for $25 per share, a rights holder could buy 10 new shares for $125. The 10% holder, however, would not be eligible to buy stock at the discounted price. The rights may be redeemed by Circus at 1¢ per right at any time before someone acquires a 10% stake in the company. If Circus is acquired in a transaction that has not been approved by the company's board of directors, the rights also have a provision entitling holders to buy shares in the acquiring company at a similarly deep discount.

Tax Consequences

The tax status of pill plans was unclear until *Rev. Rul.* 90-11, 1990-1 CB 10, in which the IRS ruled that contingent rights awarded under such plans do not create income, because the plan is contingent on a tender offer or acquisition. The ruling also concluded that such a plan does not constitute an option for purposes of Section 382. However, *Rev. Rul.* 90-11 does not address poison pill plans in general, just the specific plan that was considered in the ruling.

The ruling indicates that, at least for purposes of Section 382 attribution rules, it will apply only when rights are "similar" to those issued under the plan described in the ruling. Rights are "similar" if the principal purpose for adopting the plan is to establish a mechanism by which a publicly held corporation can provide shareholders with rights to purchase stock at substantially less than fair market value as a means of responding to unsolicited offers to acquire the corporation. That would seem to be an easy test to meet in virtually every case. Likewise, it should be fairly easy to establish that the principal purpose of the plan must be to provide rights to public shareholders to buy stock at a discount as a means of defeating a hostile bid.

However, in determining that the adoption of the plan will not be viewed as a distribution, exchange, or any other taxable event to the company or its shareholders, the Service does not address in the ruling the need for similarity to the model plan described in the ruling.

An additional element is how important it is that the adopting company have a right to pull the plug on the pill rights. In the plan in the ruling, the company retained a right to terminate the pill rights. The termination right was exercisable by the company for a limited number of days after the rights were issued (pursuant to one of several specified triggering events). As the price for exercising this termination right, the company would have to make a small cash payment to the holders of the rights, effectively forestalling the ability of the rights holders to acquire additional stock for the bargain price.

Conclusion

While not all pill plans follow the format set out in *Rev. Rul.* 90-11, there has been no suggestion yet that the no-tax-consequence ruling will not be applied to all of these arrangements. After all, if the distribution of pill rights were taxable, it is likely that recipient shareholders would not be too thrilled. ■

THE M&A TAX REPORT
Tax Institute
P.O. Box 192026
San Francisco, CA 94119

Call 1-800-852-5515 Fax 1-415-566-7310

☐ Yes! Enter my subscription for **The M&A Tax Report** at the price of only $275 for twelve full issues, including postage and handling charges. I enclose full payment by check or credit card. For Mastercard and Visa orders, enter card information below or call 1-800-852-5515. Full money-back guarantee applies to unused part of subscription.

☐ Yes! Enter my subscription for $275 and bill me.

Name ____
Title ____
Firm ____
Street ____
City/State/Zip ____
Tel. ( ) ____
For Credit Card Orders:
☐ Mastercard # ____ Exp. ____
☐ Visa # ____ Exp. ____
Authorized Signature ____