

Spin Count

by Robert W. Wood • San Francisco

In our continual review of prominent spinoffs, this month we note that Union Pacific Corp. has announced that it is spinning off the largest non-railroad operation it has, its oil and gas unit. Union Pacific anticipates selling as much as 17.25% of its resources unit in an initial public offering, and distributing the remaining part of this unit to its shareholders during 1996. The plan is subject to the condition that an advance ruling from the IRS on the spinoff be obtained. See "Union Pacific's Davidson is Appointed Chief Operating Officer; Spinoff Slated," *Wall Street Journal*, July 28, 1995, p. B12.

Anheuser-Busch Companies also has announced a spinoff of its Campbell Taggart baking unit to shareholders by mid-1996. This transaction too is subject a favorable ruling from the IRS. Campbell

Taggart is the baking unit of Anheuser-Busch, and last year accounted for approximately 12% of Anheuser-Busch's \$12.1 billion in sales. See "Busch Plans to Spin Off Bakery Unit," *Wall Street Journal*, March 27, 1995, p. A3. As in the case of many other recent transactions, Busch's spin plan is designed to focus Busch's operation on its core brewing business. Busch officials announced that both beer and baking require total and complete focus by the management groups. On the other hand, Busch still has Eagle Snacks and a theme parks unit, neither of which will apparently be shed. That might seem to undercut the "management focus" argument that is so commonly made.

Phones and Toys

Recent weeks have also seen Sprint Corp. announce a spinoff of its rapidly growing cellular unit in a transaction designed to be accomplished by mid-1996. The business purpose for this transaction seems quite slick, since news reports state the spinoff is partly necessary to meet rules of the Federal Communications Commission prohibiting a company from owning major cellular and personal communications services licenses in the same market. See "Sprint Plans to Spin Off Cellular Business," *Wall Street Journal*, July 27, 1995, p. A3.

Interestingly, the FCC rules would require Sprint only to spin off cellular systems covering about 2 million of its 20 million customer base. Sprint has nonetheless decided to spin off the whole unit rather than to handle it piecemeal. It would seem that this circumstance would offer a bullet-proof business purpose. The Sprint transaction is still somewhat amorphous, with the company not yet having determined how many shares would be spun off in the cellular transaction, or at what price.

In the much written about distribution by Petrie Stores Corp. of shares in Toys 'R' Us, Inc., the other shoe is about to fall. (See Willens, "Petrie Stores: Patience is a Virtue," 2 *M&A Tax Rep't* 11 (June 1994), p. 1; Freier and Kordana "Petrie Stores: *General Utilities* Rides Again?" 3 *M&A Tax Rep't* 2 (September 1994), p. 1.) In March of this year, Petrie distributed over 26 million shares in Toys 'R' Us to Petrie shareholders. Now Petrie plans to make a second distribution of Toys 'R' Us

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stock. After this distribution, Petrie Stores will still hold about 10.1 million Toys 'R' Us shares which are designed to cover contingent liabilities of Petrie and certain pension and lease obligations in Petrie's anticipated liquidation. See "Petrie Stores Plans a Second Distribution of Toys 'R' Us Shares," *Wall Street Journal*, July 31, 1995, p. C14.

Perot and Concessionaires

General Motors Corp. has also entered the fray, announcing a plan to spin off its large electronic Data Systems Corp. ("EDS") unit. EDS specializes in providing computer services to corporations, and General Motors originally bought it from Ross Perot for \$2.5 billion in 1984. See "GM Board Weighs EDS Spinoff," *Wall Street Journal*, August 7, 1995, p. A3. The GM plan, if effectuated, would make EDS the world's largest independent computer services company. Although EDS had been a possible spinoff candidate earlier in the year, the transaction now looks likely, provided that a number of wrinkles—including the issuance of a ruling from the IRS—can be worked out. See "GM Moves Ahead on EDS Spinoff," *Wall Street Journal*, August 8, 1995, p. A3. The size of the spinoff is staggering, with the anticipated distribution of EDS securities valued at \$22.31 billion.

Apart from the obviously necessary board and shareholder approvals, General Motors made it quite clear that an IRS ruling would be a necessary condition to ensure that the transaction would be tax-free for GM as well as its shareholders. Analysts have begun discussing the impact on GM shareholders, and the potential benefits they may realize from the spinoff. Of course, the anticipated benefit to shareholders says nothing about the benefit to GM or EDS.

The popular press suggests that EDS will benefit by opening the doors to more rapid expansion as an independent company. Just how much more elaboration will be needed to this general statement is unclear, but certainly a good deal of specifics will have to be stated. When dollars of this magnitude are at stake, the IRS can be expected to look closely. Although the press coverage of the anticipated transaction indicate that a ruling will be applied for and that one of the necessary conditions

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is a "valid corporate business purpose, as defined by the IRS," it is not yet clear what that will be. See "GM Moves Ahead on EDS Spinoff," *Wall Street Journal*, August 8, 1995, p. A3.

Interestingly, it appears that after the smoke clears from the spinoff transaction, GM and EDS would enter a long-term agreement for EDS to provide substantially the same services for GM that it does today. According to reports, GM business last year accounted for about 35% of EDS' revenue. *Id.* One wonders how this particular aspect of the transaction will fare, inasmuch as the Service has always looked to the extent of the connections between the companies following a spin.

Host Marriott Corp. has also announced a spinoff of its concessions business from its core lodging operation. The Host Marriott Corp. announcement is reminiscent of the tactic used by its predecessor company three years ago. The concessions business includes both airport and toll road concessions. The new company is to be called Host Marriott Services Corp., and will include food, beverage and retail concessions businesses that the company operates at airports, on toll roads, and at sports and entertainment attractions. See "Host Marriott Corp. Plans a Spinoff of Concessions Business from Lodging," *Wall Street Journal*, August 10, 1995, p. B3.

Recall that three years ago, Marriott Corp. spun off its hotel management operations into Marriott International, Inc., which left Host Marriott with the major real estate assets. The spinoff then was not free of ramifications. Stockholders were happy, but bondholders sued the company (plus some top executives) for securities fraud. The currently planned spin by Host Marriott is, of course, subject to a favorable ruling from the IRS. *Id.*

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Finally, James River Corp. has announced the spinoff of its communication-paper and food and consumer-packaging operations. Shares in the new company, called Crown Vantage, Inc., will be distributed to James River stockholders. With the issuance of \$500 million in long-term debt by Crown Vantage, the net proceeds of which are to be paid to James River as a return of capital, James River will reportedly use the funds to reduce its own debt. See "Terms Are Set for Spinoff Of Some Paper Operations," *Wall Street Journal*, August 17, 1995, p. B4.

Breaking Up is Easy to Do

This whirlwind of transactions has certainly been noticed. *Business Week* recently noted the trend and even dubbed it "spin-off mania." See "The Whirlwind Breaking Up Companies," *Business Week*, August 14, 1995, p. 44. Indeed, comparing the price of a public company *before* a spinoff with the combined prices of its constituent parts *after* a spinoff, the trend, experts say is a financial no-brainer.

Still, *Business Week* points out that a few of the "separate is more equal" rationales don't get proven true. Back when Ryder System, Inc. spun off Aviall, Inc. in December of 1993, Aviall shares traded at 16 $\frac{3}{8}$. On August 1 of this year, Aviall shares traded at 8 $\frac{1}{8}$. *Id.* Still, such uncomfortable examples aside, both in the public and private sectors, spins usually win all the way around. Maybe that's why we keep seeing more and more spins... ■

apparently being considered for foreign business organizations.

The notice has become widely referred to as a "check-the-box" system, because taxpayers would be allowed to do virtually just that in order to select the method of taxation that would apply to that electing organization. Although the rules may be of somewhat less concern to corporate tax practitioners than to many others (partnership tax specialists, for example, have long had to deal with the Byzantine rules of the classification regulations), the impact of the notice can hardly be overestimated. The classification regulations set forth under Section 7701 of the Code set forth a list of factors to be used in determining whether a partnership or trust should be taxed as a flow-through (partnership tax treatment) or as an entity (corporate tax treatment). The four key criteria for determining whether a partnership will be taxed as such or will be subject to corporate tax treatment are:

- Centralization of management;
- Continuity of life;
- Free transferability of interests; and
- Limited liability.

Although the Section 7701 classification regulations have been in place for quite some time, they have undergone increased scrutiny because of the advent of limited liability companies ("LLCs"), which have now proliferated in virtually every state. Applying the LLC traits to the regulations under Section 7701

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