COLUMBIA UNIVERSITY

Graduate School of Business

Investment Banking Tax Factors Fall--1999

B9301-63 Prof. Robert Willens

OUTLINE OF COURSE: As the course title implies, we will attempt to **familiarize** students with the tax principles that must be considered by corporate managers and their advisers, with respect to transactions that result in a restructuring of the corporation's business activities or capital structure. In many respects, the course will be taught from the perspective of the outside adviser (investment banker, C.P.A. or attorney), engaged to provide guidance regarding a major corporate transaction or financing decision. This approach dictates that the tax factors impacting the decision-making process should, wherever possible, be illustrated by reference to actual "deals." In general, the student will emerge from the course with an understanding of the tax planning alternatives available under the current state of the law and, in addition, gain an appreciation of the importance of tax results (and financial accounting impact, where appropriate) as an element in the process of selecting the optimum restructuring/financing alternative or vehicle.

To comprehend the current state of the law, one must consider the myriad events and milestones that motivated Congress and the Internal Revenue Service, in their legislative and administrative efforts, respectively. Accordingly, we will focus a good deal of attention on the types of transactions and financial instruments that characterized the "takeover era" that unofficially concluded with the demise of the (first) UAL buyout. Throughout the 1980s, advisers devised "tax-efficient" transaction structures that were, after relatively brief periods of utility, interdicted, or summarily eliminated, by legislation or administrative fiat. These structures generally found expression in well-known transactions, the particulars of which will be dissected during our review of how we arrived at where we are today.

At present, we find ourselves increasingly involved in structuring "strategic transactions" that are undertaken for valid commercial reasons. The late '90s has been increasingly characterized by merger and acquisition activity involving the use of equity securities of the acquirer. As a result, we will also focus considerable attention on the tax-free reorganization provisions of the law. These provisions have been recently altered by the introduction of regulations (Reg. Secs. 1.368-1(d) and (e)) liberalizing the bedrock continuity of interest and business enterprise doctrines. Nevertheless, LBOs remain popular and we will review common LBO patterns, together with the accounting convention, so-called "recap accounting", that has done much to fuel such popularity. In addition, the '90s have seen a revival of the corporate spinoff as the divestiture tool of choice; we will consider the significant tax factors - having their genesis in the repeal of the so-called "General Utilities" doctrine - that have played a role in this phenomenon. Even spinoffs, however, have been characterized by excesses; a popular spinoff structure, the venerable *Morris Trust* transaction, was exploited (through undue "monetization") in a manner that caused Congress (in 1997) to substantially eliminate the Morris Trust technique. Finally, definitive case law is only now emerging regarding the tax results associated with "positions" taken in planning and implementing leveraged buyouts and other takeover era transactions. We will study these cases (including *Kroy, Ft. Howard Corp., Indopco, Seagram, A.E. Staley, Victory Markets, Newark Morning Ledger,Norwest, FMR* and *FNMA*) and, in the process, obtain an appreciation of the risks one shoulders when advising on a transaction structure, or financial instrument, the tax profile of which is not fully addressed in the

law we currently work with. In addition, the '90s have also been marked by the emergence of a new type of financial adviser, the “workout” expert. A bankruptcy, or out-of-court financial restructuring, is fraught with tax considerations, principally focusing on the minimization of debt cancellation income and the preservation of Net Operating Losses (NOLs) and other valuable tax "attributes". Our journey through the takeover era will, of necessity, require us to focus much attention on this aspect of corporate life. In addition, 1997’s tax legislation focused attention on various forms of securities designed in some cases to achieve **both** tax and accounting advantages (MIPS, TOPRS) or, simply, an opportunity to **defer** the tax associated with an appreciated financial position (DECS, STRYPES). We will review such securities in connection with our analysis of the law’s Original Issue Discount (OID) provisions.

In summary, the student will gain an ability to **recognize** common restructuring/financing scenarios confronting management and should be in a position to propose solutions to these problems in a manner that minimizes tax outlays consistent with prudent business practice. We will gain an understanding of the current state of the law through a study of its recent history and obtain an appreciation of the outside adviser's role in the process through an analysis of actual transactions. Ultimately, the student will look at transaction possibilities through the eyes of an investment banker and, I'm confident, see opportunities for rendering sound advice in areas and situations that he or she previously thought to be unremarkable.

READING LIST: Our text will be Bittker and Eustice's *Federal Income Taxation of Corporations and Shareholders*, Sixth Edition (Warren Gorham Lamont). We will also draw heavily upon Lehman Brothers Research publications and articles from professional taxation journals which will be provided to students on the first day of class. From time to time, we will review decided cases, as well as I.R.S. pronouncements, such as regulations and key revenue rulings. In each instance, I will supply these materials. Students are expected to read, at a minimum, *The Wall Street Journal* as well as other business periodicals including *Forbes, Business Week* and *The Daily Deal*. Ultimately, the student will look at a transaction, reported on in these periodicals, from the perspective of the tax adviser and will, I’m confident, gain an appreciation of the tax objectives that serve, in a large number of cases, to dictate the particular transaction structure employed.

GENERAL APPROACH: I expect the course to be primarily qualitative in nature since our primary learning tools will be the provisions of the Internal Revenue Code and associated regulations, revenue rulings and cases. Interspersed throughout, however, will be computations of tax liabilities incurred and (hopefully) avoided, along with other calculations embodied within the various Code provisions such as, for example, the determination of the limits imposed on NOL usage following the occurrence of an "ownership change" of a “loss corporation” or the decision regarding whether to execute a Sec. 338 election with respect to the qualified purchase of the stock of such a loss corporation. We will use a lecture format and, because so much of what we'll do will be derived from a study of actual deals, there will be much opportunity for class participation as we explore the reasons why these transactions evolved the way they did. In all events, I strongly encourage questions and student observations in light of my primary goal of simulating the type of give and take that characterizes the deliberations leading up to the formulation and consummation of an actual transaction. Finally, there will be no use (on my part anyway) of computers.

FORMAL REQUIREMENTS - We are planning, as always, a final examination as well as a term paper. The exam will consist of 12 relatively brief problems (you’ll only need to answer six such problems) in which a factual situation will be presented and the student will provide the solution to the problem and, where appropriate, a brief exposition of alternatives, together with the reasons why such alternatives were not selected. The paper (which can be prepared on a group basis) should

focus on an actual deal (or financing), or general tax principle (i.e., what are the tax consequences associated with the execution of a Sec. 338 election), and, where an actual deal is selected, must address the problem confronting management, the business environment in which management was then operating, the alternatives available for solving the problem, a discussion of the route actually selected and, most importantly, the tax consequences of the plan ultimately adopted. In addition, each week, a group of four or five students (depending on the size of the class) will select a transaction that was announced during such week and prepare a brief (one or two page) summary of such transaction with particular emphasis on its tax peculiarities—The students will then present their findings to the class. The group should contact me on the Friday or Monday preceding class at which point I will review their findings with a view towards refining the group's findings. I would expect the exam, paper and presentation to account for approximately 80 percent of the final grade with class participation and other subjective factors comprising the balance. **Students are strongly encouraged to contact me—I will always have ample time— whenever they feel the need to discuss matters we have covered in class. Historically, students who took the time to reflect on such matters, and also made time to discuss them with me, have enjoyed great success in this course.** Finally, students will be competing for *The Robert and Jacqueline Willens Tax Research Competition*. This is an award we instituted in 1999 (the first winner was Xiaojing Christina Zhu—Class of 1999). It consists of a cash stipend of $5,000—divided between a winner ($2500) and two runners-up ($1250 each). The winner is honored at the Recognition Ceremony, on the day before graduation, and receives a plaque commemorating his or her achievement as well as a nice entry on his or her resume. Good luck!

SCHEDULE AND ASSIGNMENTS

CLASS 1 AND 2---SECTION A: Overview of course; tax research tools (statute, regulations, revenue rulings, private letter rulings and cases). Spinoffs/Splitoffs; commence discussion of these transactions. Review various spinoff requirements, including active business requirement, device test, distribution requisites, business purpose condition. Review Morris Trust structure and recent Congressional response to "abuses" of such structure.
READING AND ASSIGNMENTS: BITTKER AND EUSTICE (B&E) pages 11-10 through 11-64*. (T)** Volume 6 Issue 30, (T) Volume 11 Issue 130, (T) Volume 12 Issue 68, (T) Volume 11 Issue 123, (T) Volume 8 Issue 71, (N)***Volume 4 Issue 101, (T) Volume 9, Issue 23, (T) Volume 12 Issue 64, (T) Volume 9 Issue 54, (T) Volume 11 Issue 135, (T) Volume 11 Issue 126, (T) Volume 11 Issue 11, (T) Volume 9 Issue 53, (T) Volume 12 Issue 45, (T) Volume 9 Issue 63, (T) Volume 10 Issue 121, (T) Volume 12 Issue 19, (N) Volume 5 Issue 92, (N) Volume 5 Issue 106, (T) Volume 11 Issue 49, (T) Volume 11 Issue 62, (T) Volume 12 Issue 2, (T) Volume 11 Issue 125, (T) Volume 8 Issue 39.

CLASS 3 AND 4---SECTION B: Distributions with respect to stock; dividends, earnings and profits, dividends received deduction (DRD), stock dividends, redemptions of stock including distributions in "partial liquidation".
READING AND ASSIGNMENTS: B&E pages 8-8 through 8-30, 5-38 through 5-48, 8-64 through 8-82, 8-91 through 8-112, 9-6 through 9-37 and 9-47 through 9-60. (T) Volume 1 Issue 34, (T) Volume 8 Issue 20, (T) Volume 10 Issue 94, (T) Volume 1 Issue 38, (T) Volume 11 Issue 127, (T) Volume 11 Issue 77, (T) Volume 11 Issue 72, (T) Volume 12 Issue 52, (T) Volume 10 Issue 98, (T) Volume 10 Issue 108, (T) Volume 12 Issue 41, (T) Volume 11 Issue 87, (T) Volume 10 Issue 88, (T) Volume 5 Issue 27, (T) Volume 12 Issue 20, (T) Volume 10 Issue 18, (T) Volume 11 Issue 27. ARTICLE—"TRA '97 Closes Loopholes for Tax Deferrals and Conversion Of Gains Into Dividend Income".

CLASS 5 THROUGH 8---SECTION C: Mergers and acquisitions (taxable); basis allocation rules (Sec. 1060), Newark Morning Ledger—Sec. 197, "regular" Sec. 338 elections and Sec. 338(h)(10) elections, including discussion of so-called "supercharged IPOs", deduction of expenses—Indopco. LBOs, NOL survival (Sec. 382), "CERT" limitations, Sec. 384.
READING AND ASSIGNMENTS: B&E pages 10-50 through 10-113 and 14-53 through 14-106. (T) Volume 4 Issue 56, (T) "ASAP" 4/21/93, (T) Volume 6 Issue 19, (T) Volume 6 Issue 25, (N) Volume 4 Issue 47, (T) Volume 9 Issue 55, (T) Volume 11 Issue 99, (T) Volume 10 Issue 75, (T) Volume 10 Issue 96, (T) Volume 7 Issue 14, (T) Volume 5 Issue 11, (T) Volume 12 Issue 26, (T) Volume 10 Issue 69, (T) Volume 11 Issue 74, (T) Volume 12 Issue 48, (T) Volume 11 Issue 84, (N) Volume 4 Issue 65, (T) Volume 9 Issue 42, (T) Volume 11 Issue 36, (N) Volume 4 Issue 72, (N) Volume 4 Issue 61, (T) Volume 8 Issue 43, (T) Volume 11 Issue 132, (N) Volume 4 Issue 53, (T) Volume 12 Issue 15. CASE—Indopco, Inc. v. Commissioner.

CLASS 9 AND 10---SECTION D: Tax-free reorganizations; general doctrines (business purpose, continuity of interest and continuity of business enterprise). I.R.S. liberalization of these continuity tests. Types of reorganizations, treatment of participants thereto, use of Sec. 351 and

"National Starch" technique for skirting reorganization requirements. Cross-border transactions—Reg. Sec. 1.367(a)-3(c), contingent consideration, including use of escrowed stock.
READING AND ASSIGNMENTS: B&E pages 12-23 through 12-142. (T) Volume 9 Issue 85, (T) Volume 11 Issue 102, (T) Volume 11 Issue 15, (T) Volume 9 Issue 30, (N) Volume 1 Issue 16, (T) Volume 11 Issue 24, (T) Volume 12 Issue 47, (T) Volume 12 Issue 62, (N) Volume 3 Issue 123, (T) Volume 11 Issue 53, (T) Volume 11 Issue 95, (T) Volume 12 Issue 66, (T) Volume 6 Issue 18, (T) Volume 11 Issue 45, (T) Volume 9 Issue 112, (T) Volume 12 Issue 12, (T) Volume 11 Issue 40, (T) Volume 12 Issue 30, (T) Volume 11 Issue 5. ARTICLE—"New Continuity Regs. Increase Flexibility In Planning and Implementing Tax-Free Reorgs. CASE—Commissioner v. Clark.

CLASS 11---SECTION E: Restructuring; cancellation of indebtedness income (COD) and exceptions thereto.
READING AND ASSIGNMENTS: B&E pages 12-146 through 12-151. (T) Volume 4 Issue 14, (T) "ASAP" 8/31/93, (T) Volume 11 Issue 1.

CLASS 12---SECTION F: Financing vehicles; OID regulations, contingent payment debt instruments, DECs, zero-coupon convertibles (LYONs), use of preferred stock, debt vs. equity issues, MIPs, TOPRs, STRYPES. Review of 1999 tax legislation and impact on "structured" financial products.
READING AND ASSIGNMENTS: (T) Volume 12 Issue 69, (T) Volume 12 Issue 28, (T) Volume 9 Issue 61, (T) Volume 11 Issue 138, (T) Volume 9 Issue 44, (T) Volume 9 Issue 104, (T) Volume 12 Issue 43, (T) Volume 10 Issue 2.

*Bittker and Eustice reading assignments are optional but, nevertheless, encouraged.
** Tax & Accounting Issues.
***Notes.

TEACHING ASSISTANT—ALSYSON I. WALFISH