

WACHTELL, LIPTON, ROSEN & KATZ

# SPIN-OFF GUIDE



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# Spin-Off Guide

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## I.

### Overview

A spin-off involves the separation of a company's businesses through the creation of one or more separate, publicly traded companies. Spin-offs have been popular because many investors, boards and managers believe that certain businesses may command higher valuations if owned and managed separately, rather than as part of the same enterprise. An added benefit is that a spin-off can often be accomplished in a manner that is tax-free to both the existing public company (referred to as the parent) and its shareholders. Companies have also been able to tap the debt markets to lock in low borrowing costs for the business being separated and monetize a portion of its value. After reaching 98 completed spin-offs with a total global volume of \$211 billion in 2021, a year which saw record-breaking M&A activity, spin-off activity fell to 68 completed spin-offs with a total value of \$87 billion in 2022, more in line with (but at the lower end of) recent prior years. The number of completed spin-offs in 2023 was similar to 2022, though total volume rose. Spin-offs, separations and divestitures continue to compose a significant portion of deal activity in recent years as companies increasingly pursue value creation by monetizing non-core assets and focusing their businesses on core operations.

The process of completing a spin-off is complex. The issues that arise in an individual situation depend largely on the business goals of the separation transaction, the degree to which the businesses were integrated before the transaction, the extent of the continuing relationships between the businesses after the transaction, the structure of the transaction and the desire to obtain (if possible) tax-free treatment of the spin-off. If the businesses were tightly integrated before the transaction or are expected to have significant business relationships following the transaction, it will take more time and effort to allocate assets and liabilities, identify personnel that will be transferred, separate employee benefits plans, obtain consents relating to contracts and other rights, and document ongoing arrangements for shared services (*e.g.*, legal, finance, human resources and information technology) and continuing supply, intellectual property sharing and other commercial or operating agreements. If the parent is expected to own a substantial portion of the spin-off company after the closing, careful planning is also required with respect to the composition of the new company's board, independent director approval of related-party transactions, handling of corporate opportunities and other matters. In addition to these separation-related issues, spin-offs raise various issues associated with taking a company public, such as drafting and filing the initial disclosure documents,

applying for listing on a stock exchange, implementing internal controls and managing ongoing reporting obligations and public investor relations. These issues become more complex in a spin-off combined with an initial public offering or other capital markets transaction, or in a spin-off that is part of a merger or business combination.

This guide is intended to help navigate the spin-off process, from the preliminary phases through completion of the transaction. Part II of this guide describes some of the initial planning considerations relating to spin-offs, and includes a discussion of the principal reasons for spin-offs and a comparison to other separation transactions. Part III examines a broad array of general corporate separation issues that may arise in a spin-off. Part IV discusses the transaction agreements commonly executed to implement a spin-off and govern the post-spin relationship between the parent and the spin-off company. Part V identifies the principal securities law matters associated with a spin-off. Part VI examines certain tax issues, which are critical given the tax-sensitive nature of separation transactions. Finally, Part VII reviews stock exchange listing and trading considerations. A sample illustrative timetable for a spin-off (that is not preceded by an initial public offering) is attached as Annex A. A discussion of certain tax-related post-spin limitations on strategic transactions is attached as Annex B.

This edition of the guide reflects developments through April 2024.

## II.

### Initial Planning Considerations

#### A. Reasons for Spin-Offs

There are several drivers of spin-off activity. The principal reasons often cited by companies for pursuing spin-offs include the following:

- *Enhanced business focus.* A spin-off will allow each business to focus on its own strategic and operational plans without diverting human and financial resources from the other business.
- *Business-appropriate capital structure.* A spin-off will enable each business to pursue the capital structure that is most appropriate for its business, strategy, and growth or cash flow profile. Each business may have different capital requirements that may not be optimally addressed with a single capital structure.
- *Distinct investment identity.* A spin-off will create distinct and targeted investment opportunities in each business. A more “pure-play” company may be considered more transparent and attractive to investors focused on a particular sector or growth strategy, thereby counteracting the “conglomerate discount” and enhancing the value of the business.
- *Effectiveness of equity-based compensation.* A spin-off can increase the effectiveness of the equity-based compensation programs of both businesses by tying the value of the equity compensation awarded to employees, officers and directors more directly to the performance of the business for which these individuals provide services.
- *Use of equity as acquisition currency.* By creating a separate publicly traded stock for part of the parent’s businesses, a spin-off will enhance the ability of both the parent and the spin-off company to effect acquisitions using its stock as consideration.

Shareholder activism is another potential driver of spin-off activity: breakup and divestiture demands were among the most common shareholder activist objectives in 2023, accounting for 42% of all M&A-related demands (which composed roughly half of all activism demands in 2023). The proportion of global activism at companies with market capitalizations greater than \$500

million calling for break-ups or divestitures has more than doubled over the past five years (18% of all activist campaigns in 2023 focused on break-ups or divestitures, compared with 15% in 2022, 13% in 2021, 12% in 2020, 11% in 2019 and 7% in 2018). Shareholder activists have become a powerful force in the corporate landscape, and many activists agitate for “value maximizing” activity, including spin-offs. For example, in 2023, Starboard Value called on News Corporation to spin off its digital real estate business REA Group from its news assets, claiming that unloading the company’s 61% stake in REA could unlock over \$7 billion in value for shareholders. Elliott also recently made a return to former target Crown Castle where the activist once again (this time successfully) called on the company to review all strategic options, including a potential spin-off of its fiber business. Crown Castle eventually announced a comprehensive review of its fiber business and the addition of two new independent directors to its board in connection with a cooperation agreement with Elliott. In recent years, some spin-off campaigns have also been fueled by sustainability and energy transition considerations. For example, in 2021, Elliott called on SSE plc to spin off its renewables business from its electricity networks business, the former of which served to help fund the company’s energy transition strategy. Similarly, in 2022, activist investor Enkraft called on German energy giant to spin off its brown coal business; Enkraft’s spin-off proposal to RWE shareholder was ultimately rejected. More recently, in 2023, Bluebell initiated a campaign calling for Bayer to separate its crop science and pharmaceutical business units because of an alleged lack of synergies between the two divisions.

Although spin-offs often have strategic benefits, they also may involve a variety of costs and risks, including:

- the potential loss of both revenue and cost synergies due to the separation of the parent’s businesses;
- disruptions to the business as a result of the spin-off;
- separation costs;
- reduced size and diversification, which could potentially result in greater cash flow volatility and reduced access to capital markets, and which may affect credit ratings;
- the potential reduction of equity research coverage and investor focus if the separated companies are too small;

- the possibility of short-term stock price volatility as the market adjusts to the distinct investment identities of the separated companies;
- potential stock market index exclusion, depending on the size or nature of the companies; and
- the possible increased susceptibility to unsolicited takeover activity (given that the businesses of each of the two post-spin companies will be less diversified and smaller than the combined predecessor company).

Newly spun-off companies also can themselves become the subject of shareholder activism. Examples include activist investor Starboard Value's 2021 nomination of three directors to the board of Elanco Animal Health Inc., which was spun off from Eli Lilly in 2018. Also in 2021, Corteva Inc. (spun off from DowDuPont in 2019), agreed to appoint three new independent directors backed by Starboard.

## **B. Separation Transaction Structures**

It is common for a company in the initial planning phases to consider other types of separation transactions in addition to a spin-off. Separation transactions generally can be divided into two categories: (1) a sale to a third party of the business being separated and (2) a sale to public shareholders or distribution to the parent's shareholders of the stock in a new public company holding the business being separated. The decision as to which type of separation transaction to pursue depends on a variety of factors. A sale to a third party can often generate the largest amount of pre-tax cash proceeds to the parent. However, a sale or distribution of the stock in a new public company can often result in greater after-tax value to the parent's shareholders because (1) the public market may place a higher value on the business than a third party and (2) a distribution of stock in a new public company to the parent's shareholders may be tax-free to both the parent and its shareholders. A sale for cash would be a taxable transaction, and, as compared to a spin-off, there is a greater risk that a sale to a third party may not be consummated. Also, the parent can generally determine the terms and timing of a spin-off, but a sale to a third party requires due diligence by the buyer and the negotiation and execution of a definitive agreement with respect to price, timing and other terms, and the closing of such a sale will also typically be subject to various conditions over which the parent does not have complete control. Depending on the nature and size of the business to be separated, there could be a relatively small universe of buyers that may be interested in and able to acquire the business. Purchase agreements with third

parties also often include various representations and warranties about the target business, supported by post-closing indemnities, and the parent may be required to retain some or all of the historical liabilities of the business being sold. In a spin-off, on the other hand, the parent usually transfers the business to the spin-off company on an “as-is, where-is” basis, and the spin-off company typically assumes all of the historical liabilities of the business. Furthermore, it generally is possible, in the context of a tax-free spin-off, for the parent to monetize a portion of the value of the spin-off company.

Within the category of transactions involving the sale or distribution of the stock of a new public company, a variety of structures can be employed to accomplish different financial and legal objectives, including those summarized below.

### **1. 100% Spin-Off**

In a typical 100% spin-off, all shares of the spin-off company are distributed *pro rata* to the shareholders of the parent as a dividend. This results in a full separation of the two entities in a single transaction. While more complex, multiple, concurrent spin-offs (such as United Technologies Corporation’s concurrent separation into three independent, publicly traded companies and merger of the remaining aerospace parent company with Raytheon Corporation, and IAC/InterActive’s spin-off of HSN, Interval Leisure Group, Ticketmaster Entertainment and LendingTree) can be an efficient and effective means to simultaneously separate multiple businesses.

There are other corporate mechanics available for accomplishing a spin-off. For example, in 2005, IAC/InterActiveCorp (“IAC”) spun off Expedia through a charter amendment that reclassified each share of IAC common stock into a share of IAC common stock and a fraction of a share of mandatory exchangeable preferred stock that automatically exchanged into a share of Expedia common stock immediately after the reclassification. IAC used a similar mechanism for both its 2021 spin-off of Vimeo and the 2020 Match transaction. Because this structure involves a charter amendment, it requires a vote of the parent’s shareholders. By contrast, a spin-off accomplished through a dividend usually does not require a shareholder vote under the laws of most jurisdictions.

### **2. Partial Spin-Off**

In some cases, the parent may distribute fewer than all of the shares of the spin-off company. Typically, the parent would not intend to retain the remaining shares long-term, but rather would use them to generate cash proceeds or to retire

existing debt of the parent, as discussed below in Part III.B. However, as described below in Part VI, for a spin-off to be tax-free, the parent must generally distribute “control” (*i.e.*, at least 80% of the voting power of all shares and at least 80% of each non-voting class of stock) of the spin-off company and must establish to the satisfaction of the Internal Revenue Service (“IRS”) that it has a valid business purpose for retaining any shares of the spin-off company. In addition, for the spin-off transaction to be tax-free, the parent must dispose of the retained shares of the spin-off company as soon as disposition is warranted, consistent with the business reasons for retaining the shares, but no later than five years following the spin-off. For the disposition of the retained shares itself to qualify for tax-free treatment, the disposition must generally be accomplished through a debt-for-equity or equity-for-equity exchange, or a second-step *pro rata* distribution to shareholders of the parent, and meet certain other requirements, as discussed below in Part III.B.

### **3. IPO Plus Spin-Off / The “Up-C” Structure**

A parent may structure a separation transaction through an initial public offering of a portion of the common stock of the subsidiary to be separated followed by a distribution of the subsidiary’s common stock to shareholders of the parent. In the IPO, the subsidiary would sell a portion of its shares to the public in an underwritten offering, with the proceeds either retained by the subsidiary or distributed to the parent. An IPO allows the formation of a natural investor base for the subsidiary in advance of distributing the remainder of the parent’s stake in the subsidiary to the parent’s shareholders.

Creating an investor base before a spin-off may be helpful because the shareholders of the parent on the record date for the spin-off dividend may or may not wish to hold shares of the spin-off company. An IPO also allows for a trading market and market valuation of the spin-off company to be established before the distribution of the spin-off company stock to the parent’s shareholders.

For the subsequent spin-off to qualify as tax-free, the parent must generally retain shares representing at least 80% of the voting power in the subsidiary after the IPO, because the tax rules require the parent to distribute “control” (generally, at least 80% of the voting power of all shares and at least 80% of each non-voting class of stock) of the subsidiary. An IPO followed by the distribution of the offering proceeds to the parent is generally tax-free to the corporations involved if the amount of cash distributed is less than the parent’s basis in the stock of the subsidiary and certain other requirements are met. If the distribution of proceeds exceeds the parent’s aggregate tax basis in the stock of

the subsidiary, the excess would generally be includible in income of the parent either when the distribution occurs or when the parent divests the subsidiary.

Issuing low-vote stock to the public may preserve the ability to spin off the subsidiary in a subsequent step if the parent wants more than 20% of the value of the stock of the subsidiary to be issued to the public. In 2016, the IRS announced two safe harbors that allow the parent to utilize a “high-vote/low-vote” structure to obtain 80% control of a subsidiary without jeopardizing the tax-free status of a subsequent spin-off of such subsidiary. One safe harbor requires that the subsidiary’s board of directors, management and certain controlling shareholders take no action (including the adoption of any plan or policy) within 24 months of the spin-off that would unwind the “high-vote/low-vote” structure. The second safe harbor permits an unwind at any time after the spin-off if the subsidiary engages in an unanticipated third-party transaction (*i.e.*, an acquisition as to which no discussions have occurred during the 24-month period before the spin-off and there is less than 20% overlapping ownership of the subsidiary and the third-party acquiror) that results in an unwind of the “high-vote/low-vote” structure. Further, the IRS may issue rulings regarding the tax consequences of a spin-off in which a “high-vote/low-vote” structure is put into place in anticipation of the spin-off.

If the parent desires to sell to the public more than 20% of the stock of the subsidiary while preserving the ability to spin off its remaining interest in the subsidiary subsequently in a tax-free manner, an alternative to the traditional “high-vote/low-vote” structure is to structure the subsidiary as an “Up-C.” An Up-C structure generally has the following characteristics:

- the business to be separated is contributed to an operating company that is a limited liability company or limited partnership and is treated as a partnership for tax purposes;
- the public purchases low-vote stock in a newly formed corporation that holds a minority economic interest in the operating company and a majority of the vote and control over the operating company; and
- the parent holds both non-economic high-vote stock in the newly formed corporation giving it control over the corporation and at least a 50% direct economic interest in the operating company.

When the parent subsequently spins off its remaining interest after the IPO, the operating company merges with the corporation.



The Up-C structure allows the parent to sell up to 50% of the economics of the business being separated and, until it spins off the remaining interest, receive cash distributions from the operating company on a tax-efficient basis. Distributions can be received on a tax-efficient basis because the operating company is a partnership for tax purposes rather than a non-consolidated corporate subsidiary. The main downside of the structure is that the parent may pay tax on the upfront proceeds from the IPO of the corporation.

Some companies determine not to pursue a carve-out IPO because of the additional costs (such as underwriting fees), complications and uncertainty involved in an IPO. The timing of an IPO will depend in large part on equity market conditions, which could significantly delay the completion of the transaction. An IPO also raises governance issues because the parent continues to control the subsidiary between the time of the carve-out IPO and the later spin-off, resulting in fiduciary duties to the subsidiary's public shareholders.

#### **4. IPO Plus Split-Off / Split-Off to Large Shareholder**

In a split-off, the parent makes an offer to its shareholders to exchange their parent stock for all or a portion of the shares of the spin-off subsidiary. It is equivalent to a share buyback of the parent's stock using stock in a subsidiary as the consideration instead of cash. A split-off is typically done after the spin-off company has been taken public as a result of an IPO so that the established trading value of the spin-off company's shares can be used in pricing the split-off exchange ratio. In a split-off, the parent typically offers to purchase the parent stock at a premium relative to the trading price of the parent's shares. Because the parent's shareholders elect whether to participate in a split-off, ownership of the spin-off company following the transaction generally is not proportionate (unlike a spin-off, in which shareholders receive a proportionate number of shares of the spin-off company), and the transaction must be registered under the U.S. Securities Act of 1933 (the "Securities Act") because it involves an investment decision by the parent's shareholders. A split-off is also an issuer tender offer under the U.S. Securities Exchange Act of 1934 (the "Exchange Act"), and therefore the parent must comply with the tender offer rules.

There are several reasons why a parent may decide to distribute its stock in a subsidiary through a split-off versus a spin-off. First, in a split-off, the stock of the subsidiary is placed into the hands of investors who want to acquire the stock of the subsidiary, because only the parent shareholders who tender their shares in the parent will receive the subsidiary's stock. The placement of the subsidiary stock with those who elect to receive that stock may reduce the amount of sales of the subsidiary stock (and therefore downward pressure on the

subsidiary stock price) following the transaction. Second, a split-off has the effect of a share buyback of the parent's stock using stock in a subsidiary as the consideration instead of cash. Because the parent buys back its stock, there may be less earnings-per-share (or EPS) dilution in a split-off than a spin-off. The fact that a split-off is equivalent to a buyback of the parent's stock, however, also means that a split-off is typically used only if the subsidiary is small relative to the size of the parent.

A split-off can also be used to reacquire stock, generally from a large shareholder. If the transaction involves a large amount of cash, it is sometimes referred to as a "cash-rich" split-off. In this type of transaction, the parent creates a new subsidiary and contributes an "active trade or business" (*i.e.*, an operating business that the parent has owned and operated for five years or more) to that subsidiary and perhaps other business assets and cash. Assuming other tax requirements are satisfied, such as the parent having a five-year active trade or business and a valid business purpose for the transaction, the parent can then exchange stock in the new subsidiary for the parent's stock held by the large shareholder in a transaction that is tax-free. However, tax-free treatment will not apply if either the parent or the subsidiary owns investment assets (generally, cash or other liquid or inactive assets) whose fair market value constitutes two-thirds or more of the fair market value of all the assets of the parent or the subsidiary, respectively, immediately after the distribution. Moreover, the IRS has proposed regulations that, if finalized, would prevent certain "cash-rich" split-offs (or spin-offs) involving relatively small active businesses from qualifying for tax-free treatment, as described in more detail in Part VI.A.2 below.

## **5. Sponsored Spin-Offs**

A spin-off also can be combined with a significant investment transaction in a so-called "sponsored spin-off." In this type of transaction, the parent distributes the shares of the subsidiary in a tax-free spin-off concurrently with the acquisition by a sponsor of up to 49.9% of either the parent or the spin-off company. The sponsor's investment allows the parent to raise proceeds in the spin-off without having to first go through the IPO process, and can help demonstrate the value of the target business to the market. Sponsored spin-offs raise a number of complex issues, including as to valuation, capital structure and governance.

## **6. Spin-Offs Combined with M&A Transactions**

A spin-off can also be used in combination with a concurrent M&A transaction, although there are limitations on the type of such transactions that can

be accomplished in a tax-free manner, as described in more detail in Part VI.B below. For example, “Morris Trust” and “Reverse Morris Trust” structures effectively allow the parent to transfer a business to a third party in a transaction involving stock consideration that is tax-free to the parent if certain requirements are met. In a traditional Morris Trust, all of the parent’s assets other than those that will be combined with the third party are spun off or split off into a new public company and then the parent merges with the third party. In a Reverse Morris Trust, all assets to be combined with the third party are spun off or split off into a new public company and then the new company merges with the third party.

To be tax-free, the Morris Trust and Reverse Morris Trust structures generally require, among other things, that the merger partner be smaller than the business to be combined with the merger partner (*i.e.*, that the shareholders of the parent own a majority of the stock of the combined entity).

One advantage of a Reverse Morris Trust structure over a Morris Trust structure is that a Reverse Morris Trust generally does not require approval by the parent shareholders for the spin-off or merger. In a Reverse Morris Trust transaction, the parent approves the combination of the spin-off company and the merger partner at a time when the parent is the sole shareholder of the spin-off company. By contrast, a Morris Trust transaction often requires approval by the parent’s shareholders because the merging party (*i.e.*, the parent) is already a public company at the time that the merger is submitted for approval by the parent’s shareholders.

In addition, a parent may consider engaging in other types of transactions with a third party in connection with a spin-off, aligned with the strategic focus of the parent following the spin-off.

A simultaneous spin-off and M&A transaction involves additional complexity relative to a spin-off without an M&A transaction, because each transaction will typically be conditioned on the completion of the other. In addition, the acquiror and the target will often engage in extensive negotiations of the key spin-off agreements before entering into the merger agreement so that both parties have a clear understanding of which assets and liabilities will be spun off and which will be retained.

In some cases, a spin-off may come after the closing of an M&A transaction. This approach allows parties to reap the benefits of a combination while also signaling to the market an intent to rationalize the portfolio of the combined company in the future. In such transactions, if the “active trade or

business” to be relied upon by either the parent or the spin-off company was conducted only by the legal target in the merger, the spin-off may not qualify for tax-free treatment if it occurs within five years of the merger.

Yet another form of separation transaction involving an M&A transaction is a partnership transaction, with a subsequent spin-off or split-off. In this type of transaction, one company contributes a business to a partnership joint venture with another company. The company that contributes a business then reserves the right to spin off its interest in the joint venture to its shareholders in a tax-free spin-off or split-off.

Part VI.B below provides an overview of the tax considerations relevant to post-spin strategic transactions, and a more detailed explanation is attached as Annex B.

## **7. SPAC Transactions**

A surge of offerings by special purpose acquisition companies (“SPACs”) led to record levels of capital being raised by SPACs in 2020, with SPAC activity more than doubling in 2021. While SPAC activity fell precipitously in 2022 and 2023, in part because of heightened regulatory and political scrutiny and a weak private investment in public equity (“PIPE”) market, there remains a significant number of SPACs still searching for targets (approximately 100 as of the date of this writing (though a drop from around 350 as of the end of 2022) ), and SPACs continued to be a feature of the M&A landscape in 2023; one recent example includes Lionsgate’s announcement in December 2023 that its studio business will be combined with a SPAC to launch as a separate publicly-traded company. A SPAC is a company formed to raise capital in an initial public offering to finance a subsequent merger or acquisition within a time frame specified in its charter, typically two or less years. The target firm, which must not yet be identified at the time of the SPAC’s IPO, becomes public as a result of the transaction (often referred to as a “business combination” or a “de-SPAC transaction”). While many de-SPAC transactions involve taking private companies public, they can also serve as an alternative form of separation transaction by which a parent can effectively take one of its businesses public.

The SPAC market has more recently come under increased scrutiny by regulators and investors, including a series of new rules governing SPACs and de-SPAC transactions adopted by the SEC in January 2024 (to be effective 125 days after publication in the Federal Register). These rules included, among other items, enhanced disclosure requirements in SPAC IPOs and de-SPAC transactions, including with respect to compensation paid to SPAC sponsors,

conflicts of interest, dilution, and the determination, if any, of the SPAC's board whether a de-SPAC transaction is advisable.

## **8. REIT Separation Transactions**

Many companies have made substantial real estate investments in connection with their businesses. While real estate holdings give a company control over assets that can be critical from an operational perspective, they also tie up capital and may require significant management attention. One potential means of unlocking the value of a company's real estate is to split the company into an operating company and a separate real estate investment trust ("REIT") that owns the company's real estate. Long-term leases and other contractual relationships can be established between the two companies to ensure the operating business's ability to continue to use the real estate assets on satisfactory terms. Separation transactions involving REITs can be complex, given the rules that an entity must comply with to be treated as a REIT. Among other things, the REIT must have no earnings and profits from the pre-REIT period. In 2015, Congress amended Section 355 of the Internal Revenue Code to provide that a spin-off in which only one of the spin-off company or the remaining company is a REIT cannot qualify for tax-free treatment, although a transaction where a REIT spins off another REIT or a REIT spins off a taxable REIT subsidiary may still qualify as tax-free.

### **C. Internal Process Considerations**

In planning for a spin-off, it is important to understand the role of the various internal constituencies that will be involved. Some aspects of the spin-off are, in practice, often largely determined by the board and management of the parent—such as the basic decision as to which business(es) will be spun off, as well as the selection of the spin-off company's directors. Other aspects of the spin-off may appropriately involve more input from the future directors and management of the spin-off company, such as the terms of its corporate documents (*e.g.*, committee charters, governance guidelines, insider trading policies, codes of ethics and the like). Even on matters such as these, companies often decide to generally follow a "clone and go" approach by establishing a presumption in favor of using the parent's documents as models to simplify the already complex process of turning one public company into two (or more).

In some cases, a company may choose to allow managers of the business to be spun off to take a more active role in planning for the spin-off, such as where the spun-off business and the remaining business are of relatively equal size and have historically been managed independently. However, companies

should recognize that these managers may begin to view themselves in a quasi-adversarial position to the parent, as they begin to focus on positioning the business to be spun off in the most advantageous manner. The question sometimes arises whether management of the business to be spun off should have separate legal representation in connection with negotiating the terms of the spin-off, either initially or when the process is closer to completion. Separate legal representation before completion of the spin-off, where the parent owns 100% of the spin-off subsidiary, generally is inappropriate as it would unnecessarily exacerbate internal divisions and is inconsistent with the notion that it is the duty of the parent's board to establish the terms of the separation in a manner that serves the best interests of the parent shareholders (who, of course, will also be the initial shareholders of the spin-off company). Moreover, as to those matters that will not affect the parent following the spin-off (such as the spin-off company's compensation policies), the spin-off company will be able to make whatever changes it desires following the spin-off, lessening the need for pre-spin internal negotiations over these topics.

The approach to be taken in any particular spin-off on matters such as these should be considered with appropriate thoughtfulness and sensitivity, balancing respect for the role of the future directors and officers of the company being spun off with the fundamental premise that the responsibility for the spin-off rests with the parent's board and management.

### **III.**

#### **General Separation Issues**

##### **A. Identification and Grouping of Businesses**

An initial step for a spin-off is to determine exactly what will be spun off. In a spin-off of a subsidiary that has historically operated as a standalone business, this may be a relatively simple process because the business to be spun off will already be reasonably well defined. Even in that context, however, it may be necessary to add or remove operations from the subsidiary before the separation occurs. In addition, there may be important ongoing business relationships to be formalized between the parent and the company to be spun off and common support functions that will have to be divided, replicated or provided on an interim or transitional basis before the company to be spun off will be ready to operate as a standalone, publicly traded company. Tax restrictions must be taken into account in structuring any such ongoing business relationships, as discussed below in Part VI.

In a spin-off of a division or portion of a business operated through legal entities that also have operations that will remain with the parent, the corporate separation issues are far more complex because the assets and operations that will be held by the spin-off company must be identified and intercompany transfers will need to be effected. These transfers often raise complex corporate and tax structuring issues, including determining the optimal corporate mechanic for effecting each transfer (contribution, sale of assets, internal spin-off, etc.), the order and timing of various steps, required governmental and third-party consents, and many other issues that typically arise with internal restructurings. Particularly where international operations are involved, such pre-spin internal reorganization plans can involve many steps and potentially long lead times for foreign governmental approvals or necessary third-party consents, and careful planning is required to effect the internal reorganization in a timely and tax- and cost-efficient manner. It is usually preferable to develop a comprehensive plan for the internal reorganization early in the process to ensure that the required timelines can be met, but to wait to complete the internal restructuring steps until later in the process, to minimize the risk that transactions may need to be unwound in the unlikely event that the spin-off were abandoned or modified. However, in some cases the need to complete a financing in advance of the spin-off may require that the restructuring be completed earlier. In any event, the restructuring should commence sufficiently early to ensure its completion before the spin-off occurs. As discussed below in Part IV, separation and distribution agreements typically

include provisions addressing the possibility that some transfers may not be completed by the time of the spin-off.

A spin-off will also be more complicated if the spun-off business does not have substantially the same assets, business and operations as one or more of the parent's financial segments. In such cases, it will usually require significantly more time to prepare the audited financial statements and MD&A for the spun-off business that are required to be included in the Form 10 registration statement. Furthermore, a spin-off company that does not track one of the parent's financial reporting segments will not be eligible to use Form S-3 for at least 12 months after the date the spin-off company's Form 10 registration statement becomes effective, and affiliates of the spin-off company will not be eligible to use Rule 144 for sales of its securities until 90 days after the date of effectiveness.

## **B. Capital Structure Considerations**

One key step in preparing for a spin-off is to determine the capital structure of the parent and the spin-off company after the spin-off, as well as the steps required to implement the desired capital structure. A company engaging in a spin-off will generally want to reallocate its existing cash and debt between itself and the spin-off company, as well as potentially raise additional cash or repay some of its debt.

A variety of techniques can be used to implement the desired capital structure, and the optimal strategy is often driven by tax considerations and the terms of the company's existing debt. A common strategy is for the spin-off company to issue new debt in exchange for cash before the spin-off and distribute such cash to the parent, which the parent may then use to retire its existing debt. The cash distribution from the spin-off company to the parent can be effected, for example, by having the spin-off company make a cash distribution to the parent, redeem some of its own shares held by the parent in exchange for cash, pay off an intercompany payable owed to the parent, or pay cash to acquire assets from the parent. To retain favorable tax treatment, the proceeds of certain distributions made by the spin-off company to its parent must be further transferred by the parent to its shareholders or creditors. As an alternative, the spin-off company may assume some of the parent's indebtedness. However, the debt assumption may be restricted by the parent's existing debt agreements. Each of these strategies raises complex tax issues, including potentially triggering gain recognition to the parent to the extent the payment or assumption of indebtedness exceeds the parent's basis in the spin-off company's stock or assets.



A parent may, however, be able to extract value from the spin-off company in excess of the parent's basis in the spin-off company's stock or assets without recognizing gain for U.S. federal income tax purposes. The techniques for doing so involve the parent's use of debt or equity of the spin-off company to retire the parent's indebtedness. The parent's use of the spin-off company's equity for this purpose is often called a "debt-for-equity exchange," and the parent's use of the spin-off company's debt for this purpose is often called a "debt-for-debt exchange." In one variation, the parent distributes to its shareholders a portion of the stock of the spin-off company at the same time as it closes a debt-for-debt exchange, and then completes a debt-for-equity exchange with the remaining stock of the spin-off company at a later date. Another technique involves a spin-off of all of the stock of the spin-off company to the parent's shareholders with a simultaneous debt-for-debt exchange, but without a subsequent debt-for-equity exchange. Yet another structure is an IPO through a debt-for-equity exchange, followed by a subsequent distribution of the parent's remaining shares in the spin-off company.

In October 2018, the IRS issued guidance pursuant to which it will issue private rulings on the tax treatment of debt-for-debt or debt-for-equity exchanges in connection with spin-offs, provided that the taxpayer submits to the IRS representations, information, and analysis with respect to such exchanges. This guidance applies equally to private rulings on the tax treatment of the assumption of parent debt by the spin-off company and the use of cash proceeds of new debt of the spin-off company to repay parent debt. Among other requirements, except for certain situations involving the refinancing of historic parent debt, the parent's debt that is exchanged for either debt or equity of the spin-off company (or assumed by the spin-off company or repaid with the cash proceeds of new debt of the spin-off company) must have been issued before the request for an IRS private ruling is submitted and no later than 60 days before the earliest of (i) the date of the first public announcement of the spin-off, (ii) the date on which parent enters into a binding agreement to engage in the spin-off or (iii) the date on which parent's board of directors approves the spin-off. Further, the repayment of parent debt (*i.e.*, with equity, debt, or borrowing proceeds of the spin-off company) must occur within 30 days after the spin-off (or, if there are substantial business reasons for any delay, within 180 days after the spin-off). As well, in general, the amount of parent debt to be assumed or satisfied cannot exceed the "historic average" amount of parent debt. The "historic average" is determined based on the debt outstanding as of the close of the eight fiscal quarters ending immediately before the date of approval of the spin-off by parent's board of directors.

Spin-offs often require a significant array of related financing transactions—the incurrence of new term debt (in the form of a credit facility or notes) by the spin-off company, often used to fund a distribution to the parent in connection with the spin-off, the entry into a revolving credit facility or other line of credit by the spin-off company to fund future liquidity needs and, in some circumstances, the amendment or refinancing of debt of the parent to avoid defaults or in connection with the right-sizing of the now-smaller parent’s capital structure.

One significant complicating factor is that the parent and/or the spin-off company may have different creditworthiness and business plans than, and will have (sometimes significantly) smaller assets and earnings than, the pre-spin parent. As a result, the terms (including pricing, financial and operating covenants and required guarantees and collateral support) of the credit documents of the parent and spin-off company can be dramatically different than those of the pre-spin parent, particularly if the parent is an investment-grade issuer and the spin-off company will not be; therefore, such transactions can require a significant amount of new drafting, negotiation and disclosure. As a result of these considerations, the negotiation and execution of spin-off related financing can take substantially more time than corporate officers may have been accustomed to spending on similar transactions in the past.

Due to the factors discussed above, it is important that early in the spin-off planning process, companies begin to identify the optimal financing structure for each of the parent and the spin-off company, begin to consider ideal terms of their debt instruments, initiate discussions with potential financing sources and rating agencies and begin to consider the timing of the financing transactions in relation to the anticipated effective date of the spin-off (especially in light of then-prevailing market conditions). Indeed, the financing considerations will typically play a critical role in the determination of the structure for the spin-off itself, as the size of the spin-off company and the parent and their capital structures and creditworthiness (including whether or not they will receive investment-grade ratings) can dramatically affect their cost of capital and the terms of their debt.

And, because the spin-off company’s new debt documents are likely to govern its activities for an extended period, companies should also consider involving the spin-off company’s future treasury and financial officers in negotiating the spin-off company’s debt agreements, even if doing so might require identification of such officers earlier than might otherwise be planned.

With respect to treatment of existing debt, in some cases, some such debt may logically “belong” or be explicitly associated with a specific business, such

as debt used to fund the activities of a finance subsidiary or secured by assets used in a specific business. If the entity to be spun off has operated as a standalone subsidiary, an appropriate level of debt may already exist at the subsidiary level. In other cases the parent debt may need to be allocated based on the desired balance of the capital structures of the businesses to be separated, as well as tax considerations.

Existing debt needs to be reviewed to determine the limitations on assumption of the debt by each of the businesses, as well as the contours of any covenants that may limit the parent's ability to spin off major portions of its business, such as restrictions on dividends or ability to dispose of "all or substantially all" of the parent's assets, or financial maintenance tests. In some cases it may be appropriate to seek consents with respect to debt covenants. If the terms of the parent's existing debt prevent the desired allocation of debt among the various businesses, it may be possible to incur new debt at the level of the spin-off company, dividend the proceeds up to the parent and use those proceeds to repay the parent's existing debt.

Finally, the need for new financing in connection with a spin-off has the potential to introduce conditionality and risk into the execution of the spin-off transaction. If market conditions or other circumstances prevent the issuance of the required debt, then the spin-off could be delayed or even abandoned. Issuers can mitigate these risks in various ways, including by obtaining financing commitments (the conditionality of which will need to be negotiated) during the spin-off planning process or by issuing debt or entering into loan agreements substantially in advance of completing the spin-off. These approaches often come with their own risks, costs and considerations, which should be evaluated and discussed at the outset of the spin-off planning process.

### **C. Allocation of Other Liabilities**

Allocation of liabilities other than debt, such as contingent liabilities, also requires an analysis of the liabilities that logically belong with each business, as well as legacy liabilities that may be unrelated to any of the parent's current businesses. Additional consideration may also need to be given to general corporate liabilities or other shared liabilities that do not relate specifically to the parent or the spin-off company, such as shareholder litigation. In some cases, the applicable liabilities may already reside in the appropriate legal entity. In other cases, the parent and the spin-off company may need to allocate liabilities through assumption-of-liability provisions. Liability allocations may also be reinforced through indemnities from one business to the other in the separation and distribution agreement or other transaction documents. The parent and the spin-

off company often will also release each other from various liabilities. The Delaware Court of Chancery has confirmed that such customary mutual releases are presumptively appropriate and enforceable.

#### **D. Solvency and Surplus**

Care must be taken in allocating debt and liabilities in the spin-off context to ensure that the spin-off company (and the parent) are financially viable and that any solvency risks relating to either entity have been considered. In allocating debt and other liabilities and ensuring financial viability, consideration will also need to be given to the allocation of cash, cash equivalents and financial instruments such as derivatives.

Spin-offs typically involve the payment of at least one dividend—the distribution of the stock of the spin-off company to the parent’s shareholders—and often involve others, including in the form of a payment of cash from the spin-off company to the parent before the spin-off or the declaration before the spin-off of a cash dividend payable by the spin-off company to its shareholders after the completion of the spin-off. Under both state voidable transfer law and the federal bankruptcy code, dividends may be subject to subsequent attack and recoupment by the payor or its creditors if a court later determines that the payor was insolvent at the time it made the distribution. To mitigate this risk, companies may seek solvency opinions from valuation firms with respect to either or both of the parent and the spin-off company. Although these opinions are not necessarily dispositive in a subsequent litigation about the payor’s insolvency, they can be helpful in establishing solvency (along with contemporaneous market pricing data for the stock and debt of the payor, among other things) and demonstrating that the board of directors was appropriately focused on the issue. Whether the receipt of such an opinion is worth the costs ultimately depends on the specific facts, including the creditworthiness of the payor after giving effect to the spin-off.

Under the corporate law of most jurisdictions, a company may make a distribution to its shareholders only out of surplus or earnings (and only to the extent the company is not insolvent and would not be rendered insolvent by payment of the distribution). Appreciation in the value of assets, though possibly not reflected in book value, as well as contingent liabilities that may not be reflected on the balance sheet, should be taken into account in determining whether sufficient surplus exists. As with the solvency analysis, the company’s board of directors may rely on expert opinions, if appropriate (in addition to the company’s management), to determine the availability of surplus. Some states’ laws also provide a safe harbor for directors who rely on the company’s financial

statements to determine that the company has sufficient surplus to make the distribution.

While a parent has broad flexibility in allocating assets and liabilities between the parent and the spin-off company, the construct and process of a particular spin-off can lead to later claims against the parent. For example, following DuPont's spin-off of Chemours, its performance chemicals business, Chemours brought fraudulent transfer and other claims challenging the allocation of certain environmental liabilities to Chemours. Although the Delaware courts dismissed Chemours' claims based on an arbitration provision in the separation and distribution agreement, the parties ultimately agreed to a settlement that revised the liability allocation.

## **E. Governance Considerations**

### **1. Duties of the Parent Board**

Under Delaware law, the parent board's decision to spin off a business or division typically will be protected by the business judgment rule. Under the business judgment rule, the court will defer to the substance of the directors' decision and will not invalidate the decision, will not examine its reasonableness, and will not substitute its views for the board's if the board's decision can be attributed to any rational business purpose. To be entitled to the protections of the business judgment rule, the directors must satisfy the familiar duties of care and loyalty, including by acting in good faith and in the best interests of the pre-spin parent shareholders and the parent corporation. In satisfying their duty of care, directors are entitled to rely on advice from management, financial advisers, legal counsel and other experts. In addition, many companies' charters provide for exculpation of directors for breaches of duty of care to the full extent permitted by Delaware law. Following a change to Delaware law in 2022 that permits officer exculpation, officer exculpation provisions often are included in the organizational documents of newly public companies.

The directors of the parent do not owe fiduciary duties to the spin-off company. Nor does the parent or its board owe fiduciary duties to prospective shareholders of the spin-off company in their capacity as shareholders of the spin-off company, even after the parent declares its intention to spin off the subsidiary. In structuring a spin-off transaction, directors of a solvent parent owe their duties to the shareholders of the parent and may structure the transaction in a fashion that maximizes value for those shareholders. There is no duty of "fairness" as between the parent and the spin-off company. Accordingly, the parent board generally can make unilateral decisions as to the allocation of assets and liabilities

between the parent and the spin-off company, subject to insolvency and tax considerations, before the spin-off is completed.

## **2. Corporate and Governance Structuring of the Spin-Off Company**

Because a spin-off company typically is a wholly owned subsidiary or is created as a wholly owned subsidiary of the parent, its corporate structure, charter and bylaws can be established by the parent without holding a vote of public shareholders. The parent will need to select the jurisdiction of incorporation of the spin-off company, draft its constitutive documents, such as its charter and bylaws, and determine the size and composition of the board of directors, as well as board compensation and the structure of board committees. Identification and recruitment of the spin-off company's directors can be a lengthy process to which ample time should be afforded.

The parent will also need to decide whether members of the parent's board will be moved to (or sit concurrently on) the board of the spin-off company. It is generally possible for a parent and the spin-off company to have overlapping directors, although any such overlap between the parent and the spin-off company generally is limited to a minority of each board to preserve the tax-free nature of the spin-off. All other facts and circumstances should also be considered in determining the impact of overlapping directors on the tax treatment of the spin-off. For example, in situations where a spin-off is motivated by a "fit and focus" corporate business purpose (*e.g.*, to optimize the potential of each business by allowing separate management teams to focus on each business), any overlapping directors will generally be closely scrutinized to determine whether the arrangement is consistent with the stated business purpose(s) for the spin-off. Further, under the IRS's ruling guidelines regarding a retention by the parent of any stock of the spin-off company, overlapping directors are generally not permitted. If the parent decides to have overlapping directors with a spin-off company, it should consider the possibility that conflicts may arise that may make it appropriate for any such overlapping directors to recuse themselves from deliberations at each company's board. It is also important to consider whether the parent and the spin-off company could become competitors of each other in the future, because Section 8 of the Clayton Antitrust Act of 1914 (the "Clayton Act") prohibits any person from serving as a director or officer of two or more competing corporations unless the sales of competing products or services of the two companies are less than certain *de minimis* thresholds. Finally, one should be mindful that, although Institutional Shareholder Services ("ISS") and Glass Lewis do not have a stated view or policy on overlapping boards, they have policies on overboarding generally. Currently, ISS recommends voting against or

withholding votes from individual directors who sit on more than five public company boards or are CEOs of public companies who sit on the boards of more than two public companies besides their own (in which case ISS will recommend withholding only at those outside boards). ISS has also considered, but did not implement, a limit of one outside public company directorship (as opposed to two) for CEOs and an alternate limit of four public company boards for non-CEOs, and it may revisit these policies in the future. Glass Lewis generally recommends a vote against a director who serves as an executive officer (other than executive chair) of any public company while serving on more than one external public company board, a director who serves as an executive chair of any public company while serving on more than two external public company boards and any other director who serves on more than five public company boards. When an executive officer serves only as an executive at a SPAC, Glass Lewis will generally apply the higher threshold of five public company directorships. Like ISS, Glass Lewis will not recommend voting against a director at the company where he or she serves as an executive officer, but will recommend against at the other public companies where he or she serves on the board.

Often, the full slates of individuals who will serve as directors and executive officers of the spin-off company following completion of the spin-off are not formally appointed until relatively late in the process, although they may have been identified earlier on. Until that time, the spin-off company's directors and officers typically will primarily consist of a small number of personnel of the parent, which facilitates obtaining the necessary approvals and signing documents on behalf of the spin-off company.

### **3. Takeover Defenses**

The takeover defense profile of the spin-off company should be carefully considered. In many spin-offs and IPOs, the spin-off company has more antitakeover provisions in its charter and bylaws than the parent. Some companies conclude that it is preferable for the newly public company to have antitakeover provisions from the outset, as the new company may need some time to find its footing and the board of the new company could always seek to eliminate them later, whereas a decision to add antitakeover provisions made when the company is already public will likely face resistance from proxy advisory services such as ISS and governance activists. Such resistance could, in the case of protections (such as classified boards) that can be implemented only with shareholder approval, make it very difficult to adopt such protections following the spin-off or IPO. In addition, the spin-off company could be more vulnerable to hostile takeovers than the previously combined company because it has a smaller market capitalization, particularly immediately following the spin-

off, when the stock price of the spin-off company may experience relatively high volatility.

A key antitakeover provision included in the charters of some spin-off companies is a classified board structure. A classified board is one of the most effective defenses available in the event of hostile attempts to acquire board control because it provides the board with time to adequately consider a bid. Because only one-third of the board is up for election in any given year, a hostile acquiror or shareholder activist who runs a proxy fight to replace board members with its nominees would need to obtain shareholder support in two election years to replace a majority of the board members. With a classified board, directors will be under less pressure to make decisions that maximize the short-term interests of activist shareholders at the expense of the long-term interests of the company. Another advantage of having a classified board is that it enables the company to require that directors may only be removed for cause. By contrast, if the board is not classified, then Delaware law requires that shareholders have the right to remove directors with or without cause. However, as discussed below, shareholder activists and proxy advisory firms are critical of classified boards, and as such, spin-off companies increasingly are not adopting classified board structures, or are adopting them with built-in sunset provisions providing for the board classification to phase out over the first several years after the spin-off.

Other takeover defenses include: no right for shareholders to call a special meeting; no right for shareholders to act by written consent; blank check preferred stock authorization; inclusion of “fair price” provisions; advance notice provisions for shareholders seeking to make director nominations or otherwise bring business before a shareholders’ meeting; limitation on shareholders’ ability to amend bylaws; no exemption from state antitakeover statutes; and requirements that a supermajority of shareholders approve business combination transactions or changes to the company’s antitakeover defenses. In the case of a spin-off preceded by an equity carve-out, the charter may specify that some antitakeover provisions come into effect only upon the complete spin-off of the subsidiary.

Generally, spin-off companies tend not to adopt shareholder rights plans upon the spin-off. Rather, as has been the trend in recent years with established public companies, a newly public company often will keep a rights plan “on the shelf” and ready for deployment if and when needed, though in a few cases spin-off companies have adopted short-term rights plans upon spin-off where warranted by their circumstances.

Governance advisors have increasingly focused on the governance of newly public companies. ISS has issued voting guidelines under which it



generally will make adverse recommendations for directors individually, committee members, or the entire board of a newly public company (except new nominees, who are considered case-by-case) “if, prior to or in connection with the company’s public offering, the company or its board adopted the following bylaw or charter provisions that are considered to be materially adverse to shareholder rights: supermajority vote requirements to amend the bylaws or charter; a classified board structure; or other egregious provisions.” ISS considers a provision which specifies that the problematic structure(s) will be sunset within seven years of the date of going public to be a “mitigating factor.” Unless the adverse provision is reversed or removed, ISS will vote case-by-case in subsequent years. In addition, ISS will generally issue an adverse recommendation for directors individually, committee members, or the entire board of a newly public company (except new nominees, who are considered case-by-case) if the company employs a common stock structure with unequal voting rights, unless (a) the company has a sunset provision of no more than seven years from the date of going public, (b) the super-voting shares represent less than 5% of total voting power and are therefore considered to be *de minimis*; or (c) the company provides sufficient protections for minority shareholders, such as allowing minority shareholders a regular binding vote on whether the capital structure should be maintained. Glass Lewis’s guidelines provide for a one-year grace period for companies that have recently completed an IPO or spin-off, during which Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices, except in certain cases. For example, if, preceding a spin-off, the board adopts a multi-class share structure where voting rights are not aligned with economic interest, or an anti-takeover provision, such as a poison pill or classified board, Glass Lewis will generally recommend voting against all members of the board who served at the time of the spin-off if the board (1) did not also commit to submit such provision to a shareholder vote in the first annual meeting following the spin-off or (2) did not provide a reasonable sunset provision (generally three to five years in the case of a classified board or poison pill, or seven years or less in the case of a multi-class share structure). In the case of a multi-class share structure, if such provision is put to a shareholder vote, Glass Lewis will examine the level of approval or disapproval attributed to unaffiliated shareholders when determining the vote outcome. In addition, the Council of Institutional Investors issued a statement laying out investor expectations as to various governance features of newly public companies.

In addition, shareholder activists have pressured companies to remove, or agree not to include, several antitakeover defenses in spin-off companies’ governance documents. After DuPont announced that its performance chemicals

spin-off company, Chemours, would have a classified board and several other customary antitakeover protections for a spin-off or IPO company, Trian Fund Management criticized the DuPont board and subsequently launched a proxy fight. DuPont later revised Chemours' governance so that the classified board would be subjected to approval by the Chemours shareholders at the first annual meeting of Chemours shareholders. Carl Icahn has also entered into agreements with eBay, Manitowoc, Gannett and Xerox that required their respective spin-off companies to, for a period of time after the spin-off, have an annually elected board, permit shareholders to call special meetings and refrain from adopting a shareholder rights plan with a threshold below approximately 20% and/or a duration of more than a specified number of days without shareholder ratification and other similar restrictions. Likewise, Starboard Value entered into an agreement with Yahoo! that required any spin-off company to have an annually elected board and not to make changes that reduce shareholders' rights, from a governance perspective, for a period of time after the spin-off.

Notwithstanding these developments, companies considering a spin-off or IPO should, as always, focus on how to structure the governance of the new company in a manner that maximizes long-term value creation. But they also should understand the governance landscape and the implications of their choices as they chart a course for the enterprises they are creating.

Spin-off companies incorporated in Delaware have also increasingly adopted charter or bylaw provisions requiring shareholders to bring suit in Delaware, in keeping with the general trend towards adoption of such exclusive forum provisions. These provisions are not self-executing—if a plaintiff sues a company in a jurisdiction that is not identified in such company's organizational documents as the exclusive forum for adjudicating such a dispute, the company will need to litigate to enforce its forum selection provision. With respect to federal forum selection clauses, the Delaware Supreme Court has ruled that charter provisions designating the federal courts as the exclusive forum for lawsuits brought under the Securities Act are permissible under Delaware law. *Salzberg v. Sciabacucchi*, No. 346, 2019 (Del. Mar. 18, 2020). The holding thus permits Delaware corporations to include federal forum provisions in their charters, and its reasoning clearly permits them in bylaws as well. Importantly, however, the decision does not endorse the application of these provisions in every circumstance. Companies considering including a federal forum provision in bylaws or charters—and seeking to enforce such provisions once enacted—should do so only on the strength of a record reflecting robust deliberation and consideration of all relevant information.

Proxy advisory firms have generally been skeptical of exclusive forum provisions, although their policies and practices have been changing since the Delaware Court of Chancery's decision. ISS will generally recommend voting for charter or bylaw provisions that specify courts located within the state of Delaware as the exclusive forum for corporate law matters for Delaware corporations, in the absence of serious concerns about corporate governance or board responsiveness to shareholders. Glass Lewis recommends a vote against any bylaw or charter amendment seeking to adopt an exclusive forum provision unless the company: (i) provides a compelling argument on why the provision would directly benefit shareholders; (ii) provides evidence of abuse of legal process in other, nonfavored jurisdictions; (iii) narrowly tailors such provision to the risks involved; and (iv) maintains a strong record of good corporate governance practices.

Some companies undergoing separation transactions have considered providing for mandatory arbitration in the newly public company's organizational documents, which would require shareholder claims to participate in mandatory confidential arbitration. Such provisions may encounter resistance, however, as evidenced by the Carlyle Group's 2012 attempt to include such a governance provision in its organizational documents in connection with its IPO. Carlyle ultimately determined not to include this provision in the face of opposition by investors, lawmakers and the SEC. In February 2019, the SEC Chair stated that the issue of mandatory arbitration provisions is a "complex matter that requires careful consideration" when the staff allowed a New Jersey company to exclude from its proxy materials a shareholder proposal to add a mandatory arbitration provision to its bylaws. There, the Attorney General of New Jersey stated that such a provision would violate New Jersey corporate law. The shareholder's eventual suit was dismissed in July 2021, with the court ruling that the plaintiff's claim was not ripe. Under a 2015 amendment to the Delaware General Corporation Law, a corporation's charter and bylaws may not prohibit bringing internal corporate claims (which include claims based upon a violation of a duty by directors or officers or shareholders in such capacity) in the Delaware courts.

#### **4. Governance Following a Carve-Out IPO**

In a carve-out IPO, the parent may continue to own a majority of the outstanding shares of the issuer for some period of time. Ongoing board representation for the parent is appropriate in this context, but must be carefully calibrated to protect minority public shareholders and to comply with the requirements of the Clayton Act and the Sherman Antitrust Act (the "Sherman Act"), as discussed further below under "Antitrust." In the case of a company listed on the New York Stock Exchange (the "NYSE") or the Nasdaq Stock

Market (“Nasdaq”), the issuer would be a “controlled company” under NYSE and Nasdaq rules for so long as the parent owns at least a majority of the issuer after the IPO and thus would be exempt from the requirement that a majority of its directors be independent. However, the spin-off company would not be exempt from the NYSE or Nasdaq requirement that its audit committee be composed exclusively of independent directors within one year of the date the registration statement becomes effective. One alternative with respect to board composition would be for the parent and subsidiary to agree (1) that the subsidiary will nominate a slate of directors including a percentage of parent designees based upon the percentage of common stock owned by the parent and (2) to cause a percentage of the subsidiary board to be composed of independent directors.

An additional consideration in forming the board of directors in a carve-out IPO is the duty of loyalty. Although Delaware law permits a corporation, in its charter, to eliminate director liability for monetary damages for certain breaches of fiduciary duty, director liability arising from a breach of the duty of loyalty may not be so eliminated. Courts usually examine a board of directors’ decisions under the business judgment rule, but, where an inherent conflict situation arises, such as where directors are on both sides of a transaction, directors’ decisions are not entitled to the protections of the business judgment rule. In such conflict situations, directors are required to demonstrate the “entire fairness” of the transaction. A parent that continues to control its former subsidiary likewise owes fiduciary duties to the former subsidiary’s public shareholders. In addition, directors or officers of the parent who are also directors of the former subsidiary owe the same duties to both corporations. Such dual roles may create conflicts which require overlapping directors to abstain from participation in specific situations.

One mechanism for reducing the legal issues raised by conflict transactions when directors are on both sides of a transaction is for independent directors to ratify material transactions between the parent and subsidiary, a mechanism that should be utilized for ongoing transactions between the parent and its former subsidiary following an IPO. This ratification mechanism, if properly applied, would generally shift the burden of proof regarding the fairness of such transactions from the former parent and the interested directors to the challenging public shareholder.

An additional issue arising out of the duty of loyalty is the “corporate opportunity” doctrine. Under this doctrine, a director or controlling shareholder may not appropriate a business opportunity that rightfully belongs to the corporation. While there is no bright-line test for determining which opportunities “belong” to a majority-owned subsidiary and which to its

controlling shareholder, courts may consider various factors, including how closely the opportunity ties to their respective lines of business, the subsidiary's expectancy in the opportunity and the capacity in which the opportunity comes to the parent or subsidiary.

Under Delaware law, a corporation's charter may contain provisions that modify its fiduciaries' obligations regarding corporate opportunities. For example, the subsidiary's charter could contain provisions that eliminate liability on the part of the parent (as controlling shareholder) to the subsidiary or its shareholders for a breach of fiduciary duty for taking any business opportunity for itself or for failing to present the corporate opportunity to the subsidiary. In addition, the subsidiary's charter may contain provisions setting forth a procedure for allocating between the parent and the subsidiary business opportunities that are offered to persons who are directors, officers or employees of both parent and subsidiary.

## **F. Management and Employee Matters**

### **1. Composition of Employees**

Determining which employees will be employed by the parent and which by the spin-off company is a critical workstream in spin-off implementation. In the case of a subsidiary that has historically operated as a standalone entity, composition of employees will likely be reasonably straightforward. Even in such a case, however, the successful transition from a subsidiary to a separate publicly traded company may necessitate new or additional managers, and compensation programs and levels will need to be evaluated in the context of new peer companies. In spin-offs of divisions that have not been operated on a standalone basis, composition of management may pose more complicated decisions, especially where existing managers have responsibilities that overlap between businesses to be spun off and businesses to be retained, or have experience in and are valuable to both sides of the business. The needs of each business, as well as the desires of the individual managers, are important considerations in determining who is allocated to which business.

### **2. Allocation of Employee Benefits**

In addition to allocating the employee population between the two companies, an organization effectuating a spin-off must determine how to allocate employee plans and associated liabilities. Key issues may include the division of pension plans and related assets, the division of other benefit plans and related assets, the treatment of stock options and other equity-based awards, the impact of

any union contracts (including restrictions on the allocation of employees, benefits and benefit plan assets) and, for international operations, works' council or other employee consultation requirements.

The spin-off company must also determine the compensation arrangements and employee benefit plans it will have after it becomes a separate company. If employees of the spin-off company or the parent participate in bonus or other performance-based arrangements that use consolidated parent performance targets and the transaction occurs other than at the end of a performance year, adjustments to those targets may be necessary to reflect the spin-off. And if employees of the spin-off company participate in parent employee benefit plans (medical, 401(k), nonqualified deferred compensation, etc.), the spin-off company generally will need to create its own plans to provide those benefits at the closing of the transaction. Such plans are often cloned from the pre-existing parent plans and identical to the parent plans in all material respects, thereby facilitating communication to spin-off company employees that their benefits will remain intact. Those plans may also assume liabilities related to the spin-off company's employees from the related parent plans, as well as any associated assets.

### **3. Adjustments to Equity-Based Compensation Awards**

The parent's equity compensation plans, as well as individual award agreements, should be reviewed to determine whether adjustments to equity-based compensation awards granted thereunder are required or permitted in connection with a spin-off. In general, an award adjustment will be appropriate in a spin-off, in light of the change of capitalization. Subject to any restrictions in such adjustment provisions, there are two principal methodologies for adjusting equity-based compensation awards of the parent in connection with a spin-off:

- *Concentration Method.* The parent awards held by specified employees (typically, employees who will be primarily dedicated to the spin-off company) are converted into awards of the spin-off company, while the parent awards held by all other employees continue to be based on parent equity and are adjusted to reflect the decrease in value of parent equity upon the spin-off.
- *Basket Method.* All parent awards (regardless of employee) are converted into (1) an adjusted parent award and (2) a spin-off company award. This method is sometimes referred to as the "shareholder method," because the treatment closely mirrors the treatment of shares generally, or as the "bifurcated method."

The concentration method offers two main benefits. First, it more directly than the basket method ensures that employees are incentivized to maximize the value of the company for which they perform services post-spin. Second, it gives rise to fewer complications from accounting, securities law, administrative, and tax perspectives than does the basket method.

The basket method, however, ensures symmetry of treatment between award holders and shareholders, who receive shares in both companies. It more directly recognizes the pre-spin contributions by equity award holders to the value of both companies and avoids the employees of one of the post-spin companies ultimately achieving greater value on pre-spin awards than those of the other company, thereby allowing all employees to reap the benefit of the value that they have helped create, regardless of which company they work for post-spin.

*Method of Adjustment.* Equity award adjustments in spin-offs—whether in the context of the concentration method or basket method—generally aim to preserve the economic characteristics of the pre-spin award, with the intrinsic value of the post-spin award (or awards) generally equivalent to the intrinsic value of the pre-spin award, based on the relative trading prices of parent shares immediately before the spin-off and parent and/or spin-off company shares, as applicable, immediately after the spin-off. For options to purchase parent shares, both the number of shares underlying the award and the exercise price must be adjusted. For tax reasons, regardless of the method chosen, the adjustment of parent options should preserve (but not increase) as of immediately after the spin-off the aggregate spread of the options immediately before the spin-off. Although it may be possible to change the ratio of exercise price to share price immediately before the spin-off, typically that ratio is preserved in the adjusted awards. Companies should carefully consider the measurement dates and periods to be used to determine the relative trading prices for purposes of equity award adjustments.

*Overhang/Dilution.* Companies should consult their financial advisors regarding the effect of a spin-off on the overhang and dilution of each of the parent and the spin-off company.

*Accounting Charge.* The adjustment of parent awards may result in an accounting charge regardless of the method of adjustment used. While such charges are usually relatively small, they may be quite significant if the parent's equity plans do not require (as opposed to making optional) anti-dilution adjustments to awards in connection with the spin-off. Companies should consult their auditors for advice on the accounting effects of the adjustment of equity awards.

*Blackout Periods.* In connection with the adjustment of parent awards to reflect a spin-off, the parent will typically impose a blackout period on option exercises and the settlement of other awards in equity for some period before the spin-off date and thereafter to give time to implement the spin-off adjustments. The parent should notify its award holders of this fact as early as practicable in advance of the commencement of the blackout period.

#### **G. Consent Requirements**

If the spin-off company has not operated as a standalone entity, the separation may require the assignment of assets, interests in joint ventures or other partnerships, contracts and other rights, including leases, guarantees and letters of credit, between entities. Material agreements must be reviewed to determine assignability and the degree to which consents to assignment will be required, or new agreements with counterparties will need to be entered into by both the parent and the spin-off company. Agreements must also be reviewed to ensure that there are no provisions that would be unacceptable following a spin-off or sale. Government contracts, both domestic and foreign, require particular attention for any novation rights and security clearance issues in connection with a proposed assignment or change of control or if the spin-off company will be organized in a jurisdiction outside the United States. Companies should also analyze whether any domestic or foreign governmental consents will be required in connection with the separation of the businesses to be spun off and the ability to obtain such consents before the date of the spin-off.

#### **H. Antitrust**

Any IPO or spin-off involving overlapping ownership structures or boards raises potential U.S. antitrust issues and should be analyzed from this perspective. These issues could arise under Section 1 of the Sherman Act (which prohibits concerted action among competitors) and Section 8 of the Clayton Act (which prohibits interlocking directors and/or officers of many competing corporations). In general, no filing under the Hart-Scott-Rodino Antitrust Improvements Act is required for a spin-off so long as the interests in the subsidiary are distributed *pro rata* to the parent's shareholders. Depending on the distribution of businesses and assets and the relationship of the two companies post-spin, however, antitrust questions could arise regarding non-compete agreements, transition services agreements, supply arrangements and interlocking directorates.

The Department of Justice's Antitrust Division indicated in April 2022 that it was "ramping up efforts" to enforce Section 8 of the Clayton Act, and DOJ announced initial results of those efforts in October 2022, noting that directors of



several companies had resigned as a result of its inquiries. We expect the Federal Trade Commission and DOJ will continue to focus on interlocking directorate issues. When selecting nominees to serve as directors of a subsidiary post-spin, the parent should consider the parent's and subsidiary's respective businesses and review board memberships for potential competitor interlocks in light of the antitrust agencies' enforcement priorities.

#### **I. Intellectual Property**

If the business to be separated relies on intellectual property rights such as patents held by or licensed to the parent, this intellectual property may need to be allocated to or shared among the appropriate businesses. This may raise the consent issues discussed above, but with even more complexity if the parent is a licensee or if both companies need to share the intellectual property. Tax considerations also play a role if the parent and the spin-off company intend to enter into cross-licenses to allow each company to use the other's intellectual property. In addition, consideration may need to be given to the use of trademarks and trade names by the businesses to be separated. If trade names or marks are licensed by one entity to another, the licensing party must have some ability to control the use of the mark and the quality of the products or services to be sold or offered under the mark.

#### **J. Related-Party Arrangements**

Related-party transactions will have to be described in the securities filings required in connection with the spin-off. Following the separation and the listing of the spin-off company, NYSE rules require an audit committee or other independent body of the board to approve all new related-party transactions. The SEC defines a related-party transaction as any transaction in which the company was or is to be a participant and the amount involved exceeds \$120,000, and in which any related person had or will have a direct or indirect material interest. The definition of "related person" includes, among other things, any person who is the beneficial owner of more than five percent of the company's voting securities. In addition, the spin-off company's process for the review, approval or ratification of such related-party transactions will have to be described in its securities filings on an ongoing basis.

#### **K. Initial Disclosure of the Spin-Off**

Consideration of the timing of announcing a spin-off should take into account necessary financing activities, any planned stock repurchases and other disclosure issues. Absent circumstances imposing a duty to disclose material

information, the company's board of directors generally can determine when to announce that the company is pursuing a separation transaction or spin-off. Preliminary consideration by the board does not mandate public disclosure, and the timing of disclosure generally is not dictated by legal strategy. Before disclosing an intended spin-off, companies should complete enough preliminary work to be confident that, once the anticipated spin-off has been announced, it can be completed; therefore, the company should have a general understanding of the expected costs of implementing the transaction and the likely time frame and confirm that there are no "show-stoppers" that would prevent completion of the transaction. While "no comment" is generally the best strategy in case of rumors, such a situation would have to be evaluated based on all factors existing at the time. In addition, the seriousness of consideration of the potential transaction, and the likelihood of its occurrence, need to be monitored in the context of any proposed purchases or sales of stock by executives having knowledge of the potential transaction.

A spin-off is typically preceded by an announcement that the parent plans to pursue a separation of a business. This announcement does not preclude other alternatives that may arise, including retaining or selling the business if warranted by the circumstances. For example, Marathon Petroleum announced its intention to spin off its gas station business Speedway before it announced the sale of Speedway to 7-Eleven, and Nielsen announced its plans to spin off Global Connect, its market-analytics business, prior to announcing the sale of Global Connect to Advent International. Likewise, in February 2023, FIS announced its plans to spin off of its Merchant Solutions business; it later completed the sale of a majority stake in its Merchant Solutions business to private equity funds managed by GTCR.

#### **L. Shareholder Vote**

The laws of most jurisdictions require a shareholder vote for the "sale or other disposition of all or substantially all" of a company's assets. In Delaware, the shareholder vote requirement is triggered if the corporation wishes to "sell, lease or exchange all or substantially all of its property and assets." Because a spin-off is effected by means of a dividend of shares of the spin-off company (as opposed to a sale of assets), there is law supporting the proposition that a spin-off does not constitute a sale, lease or exchange within the meaning of the Delaware statute, and therefore shareholder approval is generally not required. Consistent with this analysis, shareholder approval has not been sought in significant spin-offs by Delaware companies. In other jurisdictions, however, such as New York, the analogous statutes governing sales or transfers of substantially all of a

company's assets potentially apply to spin-offs, and, accordingly, careful consideration should be given as to whether a shareholder vote is required.



## IV.

### Transaction Agreements

#### A. Generally

A parent typically enters into a number of agreements with the spin-off company to implement the spin-off and establish a framework for their relationship following completion of the spin-off. Typically, these include a separation and distribution agreement, a transition services agreement, an employee matters agreement and a tax matters agreement. In some cases, certain of these agreements may be combined (*e.g.*, employee matters may be addressed in the separation and distribution agreement), or alternatively may appear in separate agreements. For example, if one company will rely on the other company for the supply of services, systems, raw materials, equipment, etc., on a commercial basis, the companies may enter into separate commercial agreements governing those relationships. Companies also may enter into patent, trademark and other intellectual property agreements. The terms of any intercompany arrangements, particularly any long-term arrangements, must be carefully structured and reviewed to ensure that they will not jeopardize the tax-free nature of the spin-off. Generally, long-term or commercial arrangements between the companies must be on arm's-length terms, including arm's-length pricing.

SEC rules require that forms of the material transaction agreements be filed as exhibits to the Form 10 registration statement, and as exhibits to the spin-off company's periodic reports following completion of the spin-off. Schedules and similar attachments to these agreements and to any other documents required to be filed by the spin-off company as exhibits to the Form 10 registration statement need not be filed, unless they contain material information that is not otherwise disclosed in the exhibit or in the Form 10 registration statement. In addition, a spin-off company may redact provisions or terms of the material transaction agreements and other material contracts required to be filed as exhibits to the Form 10 registration statement if the spin-off company customarily and actually treats that information as private or confidential and if the omitted information is not material. Companies should be cognizant of the potential for public disclosure in determining the form and content of the agreements and their schedules.

## **B. Separation and Distribution Agreement**

The separation and distribution agreement sets forth the agreements between the parent and the spin-off company regarding the principal corporate transactions required to effect the separation and other agreements governing the relationship between the parties. The separation and distribution agreement identifies assets to be transferred, liabilities to be assumed and contracts to be assigned to each of the spin-off company and the parent in implementing the separation, and it provides for when and how these transfers, assumptions and assignments will occur.

Generally, the asset and liability transfer provisions are structured similarly to those in an asset purchase agreement for a divestiture transaction. The agreement will define transferred assets, assumed liabilities, excluded assets and retained liabilities, in each case through a combination of categorical descriptions of the relevant assets and liabilities (*e.g.*, “all liabilities primarily related to [the spun-off business]”) and references to schedules (such as lists of real properties, patents, etc.). In drafting the categorical descriptions, decisions will need to be made as to the breadth of the defined categories (*e.g.*, “primarily related,” “exclusively related” or “to the extent related”). The agreement will also typically reference the pro forma balance sheet of the spin-off company in defining its assets and liabilities. It is generally preferable to specifically list the relevant assets and liabilities in schedules to the agreement, except to the extent doing so is unduly cumbersome or they clearly fall within the enumerated categories. In some cases, a separation and distribution agreement may include a working capital or other balance sheet adjustment, which may be similar to those that are included in private M&A agreements, or may be more customized depending on the nature of the spun-off business and the desired capital allocation approach. Such adjustments or customizations may, however, exacerbate the risk of post-spin disputes between the parent and spin-off company and should therefore be carefully evaluated.

As described above, a separation and distribution agreement typically provides for the business to be transferred on an “as is, where is” basis—*i.e.*, without any representations as to financial statements, undisclosed liabilities, litigation or other matters that typically are addressed in representations and warranties in a purchase agreement with a third party. The separation and distribution agreement usually will provide for cross-indemnities designed to place financial responsibility for the obligations and liabilities of the spun-off business with the spin-off company and financial responsibility for the obligations and liabilities of the parent’s remaining business with the parent, among other indemnities. In general, each party to the separation and distribution agreement

assumes liability for all pending, threatened and unasserted legal matters related to its own business or its assumed or retained liabilities. Some companies may also choose to do a “rough justice” split of liability for shared or corporate legal matters that cannot be easily allocated to one business.

Similar to purchase agreements for a carve-out divestiture, separation and distribution agreements generally include provisions intended to account for the possibility that assets, liabilities, contracts, permits or other items contemplated to be transferred cannot be transferred at the closing due to the failure to obtain required consents or approvals or to make required notifications or, in some cases, delayed regulatory approval. To this end, separation and distribution agreements typically include provisions intended to transfer the economic benefits and burdens of ownership of the relevant items to the applicable party until the consent, approval or notification (or regulatory approval) has been made or obtained, with legal title to follow when the transfer is completed. These provisions also typically impose obligations to continue to use efforts to complete such transfers.

The separation and distribution agreement also governs the rights and obligations of the parent and the spin-off company regarding the distribution of the spin-off company’s shares and sets out the conditions to the distribution. Usually, the conditions to the distribution include, at a minimum: effectiveness of the Form 10 registration statement and delivery (by mailing or electronically) of the related information statement to shareholders; approval of listing of the shares of the spin-off company’s common stock on the applicable stock exchange; receipt of an opinion of tax counsel as to the tax treatment of the spin-off (if it is intended to be tax-free); absence of injunctions prohibiting the spin-off; and a “catch-all” condition that there has been no adverse event that, in the judgment of the parent’s board of directors, makes it inadvisable to complete the spin-off. Other conditions that are sometimes included are completion of the internal restructuring plan (if any), receipt of a private letter ruling from the IRS relating to the tax treatment of the spin-off, delivery of solvency/surplus opinions and completion of the distribution of financing proceeds obtained by the spin-off company, if applicable.

The separation and distribution agreement also generally outlines obligations with respect to retention of information and confidentiality and describes the circumstances under which the parent and spin-off company are obligated to provide each other with access to information. The agreement also often deals with insurance matters, including allocation among the parties of rights and obligations under existing insurance policies or captive insurance

arrangements with respect to various claims or occurrences and procedures for the administration of insured claims.

As a result of the conditions to the distribution, as well as the typically broad termination and amendment rights in favor of the parent, the parent will often retain great contractual freedom to modify, delay or abandon the transaction until it is completed. In some cases, the separation and distribution agreement (and other transaction agreements) are not entered into until very late in the process. However, significant deviation from publicly announced plans may be viewed unfavorably by the markets.

Spin-off transaction agreements sometimes provide for arbitration of disputes between the parent and the spin-off company, although the appropriate dispute resolution mechanism should be considered in light of the particular facts and circumstances and preferences of the company.

### **C. Transition Services Agreement**

The transition services agreement typically will cover services that are shared by the businesses to be separated, such as legal, payroll, accounting, information technology or benefits, which may have to be continued on an interim or transitional basis after the separation of the businesses. In some cases, only one party provides the services (*e.g.*, from the parent to the spin-off company), whereas in other cases both parties provide services to each other. Pricing of these services as well as the period of time over which they will be provided will need to be considered from both a business and tax perspective.

To preserve the tax-free nature of a spin-off, transition services agreements should cover only administrative and other back-office support services and should generally have terms of no longer than 12 to 24 months. The parties may often provide these services under such short-term transition services agreements on a cost or cost-plus basis, although the tax implications of the terms of such agreements will need to be considered in light of all the facts and circumstances. As described above, services that the parties will provide on a long-term basis or that are operational or commercial (and not administrative) in nature should be provided on arm's-length terms, including arm's-length (rather than cost or cost-plus) pricing.

As in a sale transaction, the body of the transition services agreement typically addresses matters such as service standards, termination and renewal rights, liability limitations and indemnification, while the scope and duration of the services are described in schedules.



#### **D. Tax Matters Agreement**

In connection with the separation, parties generally enter into a tax matters agreement that governs the rights, responsibilities and obligations of the parent and spin-off company after the spin-off with respect to taxes, including taxes, if any, imposed on the spin-off or related transactions (such as any internal restructuring transactions undertaken in anticipation of the distribution).

The tax matters agreement allocates tax liabilities between the parent and the spin-off company. One way to do so is on a pre- and post-closing basis (*i.e.*, the parent is responsible for all taxes related to the period before closing, and the spin-off company is responsible for all taxes in respect of the spun-off entities related to the period after closing). A second approach allocates liabilities based on a “line-of-business” split (*i.e.*, the parent is responsible for all taxes in respect of the businesses it retains and the spin-off company is responsible for all taxes in respect of the spun-off business, regardless of the time period to which such taxes relate). A third approach is to let taxes “lie where they fall” under the law (*i.e.*, the legal entity on which the tax is imposed under the law is also responsible for the tax as between the parties). Often, a tax matters agreement will adopt different approaches for different types of taxes. For example, federal income taxes might be allocated on a pre-closing/post-closing basis, while sales taxes might be allocated based on a line-of-business split and transfer taxes based on a legal entity approach.

The tax matters agreement also assigns responsibilities for tax compliance matters, such as the filing of returns, payment of taxes due, retention of records and conduct of audits, examinations or similar proceedings. In addition, the tax matters agreement provides for cooperation and information sharing with respect to tax matters.

To protect the tax-free nature of the spin-off or related transactions, the tax matters agreement often contains restrictions on the spin-off company’s ability to take actions for the two-year period following the spin-off without obtaining either the parent’s consent or an IRS ruling or an opinion of counsel that the action will not affect the tax treatment of the spin-off or related transactions. Such restrictions typically include restrictions on any transaction that would result in a significant change in ownership of the spin-off company (whether via a merger of the spin-off company or otherwise), a liquidation or merger of the spin-off company, a sale of a substantial portion of the spin-off company’s assets, and certain repurchases of the stock of the spin-off company. Moreover, the tax matters agreement generally will provide that the spin-off company is responsible for any taxes imposed on the parent as a result of the failure of the spin-off or

related transactions to qualify as tax-free under applicable tax law if such failure is attributable to certain actions taken by the spin-off company or its shareholders, regardless of whether the parent consents to such actions or a ruling or opinion is obtained permitting such actions.

#### **E. Employee Matters Agreement**

The parent and the spin-off company generally will enter into an employee matters agreement in connection with the separation to allocate liabilities and responsibilities relating to employment matters, employee compensation and benefits plans and programs, and other related matters. The employee matters agreement typically specifies the method of adjustment of equity compensation awards (see discussion in Part III.F.3 above), and addresses any assumption by the spin-off company of any employee benefit plans or of employment or similar agreements between the parent and members of the spin-off company's management team, as well as any other assets and liabilities under parent employee benefit plans that are being shifted to the spin-off company.

#### **F. Intellectual Property Arrangements**

There may be technology and intellectual property (*e.g.*, patents and trademarks) to be shared, on either a transitional or long-term basis, between the companies following the spin-off. In such cases, the parent and the spin-off company may enter into intellectual property sharing arrangements in which the company that will own the intellectual property following the spin-off will license the shared intellectual property to the other company to use in its respective business. The complexity of the license to shared intellectual property and the terms of the license may determine whether these licenses are best addressed as a provision in the separation and distribution agreement or as a separate license agreement.

## V.

### Securities Law Matters

#### A. Principal Securities Law Filings

The primary disclosure document in connection with a spin-off that is not preceded by an IPO is a registration statement on Form 10 filed by the spin-off company. The Form 10 registers the class of shares being distributed under the Exchange Act. The Form 10 contains an information statement that parent disseminates to all of its shareholders and provides disclosure with respect to the spin-off company similar to what would appear in an IPO prospectus. The Form 10 also must include audited financial statements of the spin-off company, including two years of balance sheets, three years of income statements, three years of cash flows and three years of statements of shareholder equity, as well as unaudited stub period financials for interim quarters, if applicable, and five years of selected financial data. (The requirements for an “emerging growth company” are different, as discussed in Part V.C below.) Therefore, if the spin-off company does not already have audited financial statements, audit work should commence on preparing carve-out financials in sufficient time to be completed for the initial Form 10 filing. As with the financial statements included in other types of registration statements, the financial statements in the Form 10 are subject to the so-called “staleness” rules regarding age of financial statements, and the SEC will not commence review of or declare effective a Form 10 that contains stale financials. Spin-off companies should plan for the need to update financial information from the initial filing of the Form 10 through its effectiveness.

The Form 10 is typically reviewed by the SEC, which may take several months to complete. One preliminary question is whether to publicly file the initial Form 10 or to utilize the SEC’s nonpublic review process. Since 2017, the SEC has accepted and reviewed nonpublic draft submissions of the initial Form 10 and any amendments so long as the spin-off company confirms to the SEC in a cover letter to the nonpublic submission that it will publicly file the Form 10 and the nonpublic draft submissions at least 15 days before the anticipated effective date of the Form 10. Among other advantages, the nonpublic draft submission process may ease the burden of preparing financial statements for the Form 10. The SEC has stated that an issuer may omit from a nonpublic draft of a registration statement interim and annual financial information that it reasonably believes it will not be required to present separately at the time the registration statement is publicly filed. The issuer may not omit any required financial information from its filed registration statements. For example, if a calendar-year

spin-off company submits its initial registration statement on a nonpublic basis in November 2024 and reasonably believes that it will first publicly file the registration statement in April 2025 when annual financial information for 2024 will be required, it would be able to omit from its draft registration statement its 2021 annual financial information and interim financial information for 2023 and 2024 because this information would not be required at the time of its first public filing in April 2025. The ability to omit financial information is particularly useful when it allows the spin-off company to avoid auditing one year of historical information because the initial submission of the registration statement occurs in one fiscal year and the public filing of the registration statement is expected to occur several months into the following fiscal year. Though the nonpublic draft submission process may facilitate this potential cost-savings and allow for SEC comments to be addressed before the first public disclosure of the Form 10, companies may nevertheless choose to publicly file their initial Form 10 and amended versions sooner to demonstrate to investors that progress is being made on the spin-off and to provide investors with information about the spin-off company's business and financial performance (and because the nonpublic draft submissions will ultimately become public in any event).

If the spin-off company will have significant equity investees or has recently acquired significant businesses, the Form 10 may also need to include separate audited historical financial statements of these entities. Planning for the spin-off should include sufficient lead time to perform these audits and, if required, obtain the consent of the equity investee to disclose its financial information in the Form 10.

The following outlines the primary sections of a typical Form 10 information statement:

- Questions and Answers About the Separation
- Information Statement Summary
- Summary Historical and Unaudited Pro Forma  
Combined Financial Data
- Risk Factors
- Cautionary Statement Concerning Forward-Looking  
Statements
- Dividends
- Capitalization
- Unaudited Pro Forma Condensed Combined  
Financial Statements
- Selected Historical Combined Financial Data  
Business

Management's Discussion and Analysis of  
Financial Condition and Results of Operations  
Management  
Compensation Discussion and Analysis  
Executive Compensation  
Certain Relationships and Related-Person  
Transactions  
Security Ownership of Certain Beneficial Owners  
and Management  
The Separation  
Relationship with Parent Following the Separation  
Material U.S. Federal Income Tax Consequences  
Description of Material Indebtedness  
Description of the Spin-off Company's Capital  
Stock  
Audited Historical Financial Statements (including  
accountants' audit opinion)

The exhibits to be filed with the Form 10 typically include the following:

Charter  
Bylaws  
Financing agreements  
Material contracts (whether relating to the spin-off,  
intercompany arrangements, or the business of the  
company to be spun off)  
Benefit plans, arrangements and contracts  
List of subsidiaries

If the forms of transaction agreements and organizational documents of the spin-off company have not been completed by the time of the initial filing, they may be excluded from the initial filing. Likewise, the initial Form 10 filing need not identify initial directors and officers or set out the proposed dividend policy, capital structure or description of indebtedness.

If the company plans to go to market with a bond offering, all material information will need to be disclosed in the offering memorandum or prospectus, even if the offering occurs in advance of the effectiveness of the Form 10. It is advisable to file the initial Form 10 sufficiently in advance of the bond offering to be able to go through at least one round of SEC comments on the Form 10 before completing the offering memorandum or prospectus.

Registration of the dividend of the spin-off shares under the Securities Act is generally not required. The Staff of the SEC issued Legal Bulletin No. 4 in 1997 to address common securities law issues relating to spin-offs. The Staff specified five conditions that must be met to avoid registration under the Securities Act in a spin-off not preceded by an IPO:

- the parent shareholders do not provide consideration for the spun-off shares;
- the spin-off is made *pro rata* to parent's shareholders;
- the parent provides adequate information about the spin-off and the subsidiary to its shareholders and the trading markets through a document such as a Form 10 information statement;
- the parent has a valid business purpose for the spin-off; and
- if the parent spins off "restricted securities," it has held those securities for at least two years (although this requirement does not apply where the parent forms the subsidiary being spun off, rather than acquiring the business from a third party).

The requirement to provide "adequate information" in the third bullet point above is typically satisfied by mailing the information statement included in the Form 10 to shareholders in advance of the distribution. In recent years, companies completing spin-offs have increasingly relied on a "notice and access" process to mail a short notice of the online availability of the information statement to shareholders in lieu of the full information statement.

In the case of an IPO that precedes a spin-off, the initial offering must be registered under the Securities Act, generally on Form S-1. The Form S-1 will contain disclosure similar to that described above for a Form 10 and is typically subject to a similar full review by the SEC. The Form S-1 will also typically include the same exhibits as a Form 10, as well as accountant consents and a legal opinion as to the shares being registered. The company also will need to file a registration statement on Form 8-A before the IPO to register the class of shares being sold under the Exchange Act, which typically simply incorporates by reference the relevant information and exhibits from the Form S-1. The SEC's procedures and policies regarding nonpublic submissions of draft registration statements also apply to a Form S-1, and emerging growth companies are entitled to additional relief with respect to a publicly filed Form S-1, whereby the issuer may omit certain financial information that it reasonably believes will not be

required to be included in the registration statement at the time of the contemplated offering.

When a spin-off follows a prior IPO, a full Form 10 filing is not required because the company is already subject to Exchange Act reporting obligations. Instead, upon distribution of the remaining shares in the spin-off company held by the parent, the parent only needs to provide more limited information about the spin-off to its shareholders, such as the tax consequences of the spin-off and treatment of fractional shares, and this document is not typically subject to SEC review. If a company disposes of its remaining shares in the spin-off company by means of a split-off, then the split-off exchange offer must be registered under the Securities Act, generally on Form S-4. The exchange offer also will be subject to the tender offer rules, which require that the parent file a Schedule TO. The spin-off company can use the SEC's nonpublic submission procedures for a Form S-4 submitted within 12 months of the Form S-1 becoming effective (though such procedures are different from those for an initial registration statement).

The spin-off company will be primarily liable for any violations of the securities laws in connection with an IPO. If the parent is a selling shareholder in the IPO, it may also be primarily liable for violations of the securities laws. Moreover, if the parent is not a selling shareholder, it may still be secondarily liable for primary violations of the securities laws under the theory of "controlling person liability." Generally, a Form S-1 is subject to more stringent liability standards than a Form 10.

## **B. Eligibility of Subsidiary to Use Form S-3**

A spin-off company may desire access to the public equity and/or debt markets soon after the spin-off is consummated, for example, to refinance short-term debt allocated to it. One of the eligibility requirements to use Form S-3, which reduces the time and expense needed to register securities, is that the issuer has timely filed Exchange Act reports for at least 12 months. The SEC Staff stated in Staff Legal Bulletin No. 4 that a spin-off company may inherit its former parent's Exchange Act reporting history for purposes of becoming eligible to use Form S-3 at the consummation of the spin-off if:

- it was eligible to use Form 10 in the spin-off under the conditions described above;
- the parent is current in its Exchange Act reporting; and

- the spin-off company will have substantially the same assets, business and operations as a separate segment in the parent’s financial reporting for at least 12 months before the spin-off.

### **C. Emerging Growth Company Status**

If the spin-off company qualifies as an “emerging growth company” under the Jumpstart Our Business Startups (JOBS) Act, it will be able to take advantage of certain provisions of the JOBS Act and the Fixing America’s Surface Transportation (FAST) Act that reduce the burden of being a public company. For example, the spin-off company will only need to include three (instead of five) years of selected financial information in any Exchange Act registration statement or periodic report, need not include an auditor’s attestation on the effectiveness of internal controls over financial reporting in its Form 10-K and may provide more limited executive compensation disclosure in the Form 10 and periodic and other reports. Emerging growth companies may also elect to opt out of the requirement to comply with new or revised accounting policies until such policies are also applied to private companies, and are exempt from rules on rotation of accountants.

A spin-off company can qualify as an emerging growth company if it had less than \$1.07 billion in total annual gross revenues during the most recently completed fiscal year. Once qualified as an emerging growth company, the spin-off company will retain the status until the earliest of: the last day of the fiscal year during which the company had total annual gross revenues of \$1.07 billion or more; the date on which the company has, during the prior three-year period, issued more than \$1 billion of non-convertible debt; the date on which the company is deemed to be a “large accelerated filer” under the Exchange Act; and the last day of the fiscal year following the fifth anniversary of the company’s first registered sale of common equity pursuant to an effective registration statement under the Securities Act.

### **D. Other SEC Filings**

The spin-off company also typically files one or more Forms S-8 to register the issuance of equity under its employee benefit plans (including equity awards of the spin-off company granted to parent employees). If any former parent employees (excluding persons who become employees of the spin-off company and its subsidiaries) will hold equity awards with respect to the spin-off company’s securities, then the spin-off company will probably need to file a Form S-1 or, if eligible, a Form S-3. The spin-off company typically would file such a required Form S-1 shortly after the information statement is finalized (or, if



eligible, would file a Form S-3 on the distribution date). If the spin-off company files a Form S-1, the SEC typically would not comment on the filing extensively because the disclosures in the Form S-1 would largely correspond to disclosures contained in the Form 10 information statement.

In addition, the directors and executive officers and significant shareholders of the spin-off company will need to make Section 16 filings such as Forms 3 and 4. The parent, as sole shareholder, and the spin-off company's directors and executive officers serving on the day the SEC declares the Form 10 effective, must each file a Form 3 no later than the close of business that day. Directors and officers appointed after the Form 10 is effective need to file a Form 3 within ten business days of their appointment. The parent will also need to file a Form 4 reflecting its disposition of the spin-off company's stock in the spin-off distribution. Although the SEC has issued no-action letters indicating that directors and officers generally need not file a Form 4 to reflect the *pro rata* adjustment of their equity-based compensation into awards of parent and spin-off company stock, the company and its advisers should analyze carefully the terms of directors' and officers' existing awards and the adjustment formulas to determine whether those individuals must file Forms 4.

The parent will typically file a Form 8-K when the parent board of directors declares the spin-off dividend. Upon completion of the spin-off, the spin-off company typically files a Form 8-K reporting its entry into material definitive agreements with the parent, changes in board and executive officer composition, amendments to its organizational documents and any press release issued by the spin-off company to announce its entry into the public markets. Similarly, the parent typically files a Form 8-K reporting completion of the transaction. If the spin-off constitutes a disposition of a significant amount of assets within the meaning of Form 8-K Item 2.01, the parent will need to file pro forma financial information reflecting such disposition on Form 8-K within four business days of the closing of the spin-off.

#### **E. Obligations upon Effectiveness of the Registration Statement**

Once the SEC declares the spin-off company's Form 10 effective—or, if the spin-off will be preceded by an IPO, once the Form 8-A is effective—the company will be subject to the Exchange Act's periodic reporting requirements, including the filing of current reports on Form 8-K to report material events (subject to limited exemptions before the completion of the spin-off). The spin-off company will also need to file a quarterly report on Form 10-Q and an annual report on Form 10-K for the period in which the registration statement became effective, even if the deadline under the Exchange Act to file such Form 10-Q or

Form 10-K occurs before the completion of the spin-off (although a Form 10-Q or Form 10-K filed when the spin-off company is still a wholly owned subsidiary of the parent may omit the MD&A, most of the Part III information of the Form 10-K and certain other information). The deadline for filing the first quarterly report of a spin-off company is the later of (a) 45 days after the effective date of the Form 10, and (b) the date on which the report would have been required to be filed if the issuer had been required to file reports on Form 10-Q as of its last fiscal quarter. For annual reporting, if the effective date of the Form 10 was within 45 days after the fiscal year-end, but the Form 10 did not include the audited statements of the just recently completed year, the spin-off company must file an Annual Report on Form 10-K within 90 days after its fiscal year-end. Moreover, following the effectiveness of the applicable registration statement, the spin-off company will be subject to the Exchange Act's proxy, insider reporting and short-swing profit liability provisions, and will be subject to the Sarbanes-Oxley Act, including provisions related to loans to executive officers and directors (which, in the case of an IPO, actually become effective upon filing of the Form S-1, and not only at effectiveness), director independence, and attorney "reporting up." Companies should consider the timing of actions undertaken in connection with the separation in light of these requirements.

A newly public company does not become subject to certain requirements relating to management's annual report on internal controls over financial reporting and the required auditor's attestation in a Form 10-K until the second annual report that it is required to file with the SEC. However, if a newly formed public company seeks to use and is deemed eligible to use Form S-3 on the basis of another entity's reporting history as described in Part V.B, then the newly public company would be considered an accelerated filer and therefore be required to comply with these requirements in the first annual report that it files.

Establishing the necessary internal controls over financial reporting, as well as disclosure controls and procedures more broadly, is a complex process that involves substantial planning and coordination among internal financial reporting and legal personnel, the board of directors (particularly the audit committee) and outside auditors. In some cases, the newly public company may need to upgrade its systems in connection with its separation, including purchasing computer hardware infrastructure, implementing additional financial and management controls, reporting systems and procedures and hiring additional accounting, finance and information technology staff. Moreover, the newly public company may be reliant on its former parent for services relating to some of its internal controls over financial reporting. Careful consideration will need to

be given to these issues for the company to meet its obligations regarding internal controls.

Following approval for listing on an exchange (which will occur before the commencement of “when issued” trading in the spin-off company’s stock), the spin-off company will also be required to comply with the relevant exchange’s quantitative and qualitative criteria for continued listing, including substantive corporate governance requirements. For example, even though the spin-off company will still be a wholly owned subsidiary of the parent, as of the listing date, a spin-off company listing on the NYSE or Nasdaq must (1) have at least one independent director, (2) have at least one independent member on its audit committee and (3) identify all of the directors to be appointed to the spin-off company’s board and its audit, compensation and nominating committees as of the spin-off date. A spin-off company listing on Nasdaq must also (4) have at least one independent member on its compensation and nominating committees, although this can be the same individual appointed to the audit committee.

As of the time of the spin-off, the spin-off company must have (1) at least three members on its audit committee, one of whom must be independent, (2) a compensation committee and nominating committee, each of which must include at least one independent director, (3) audit, compensation and nominating committee charters posted on its website and (4) corporate governance guidelines and code of business conduct and ethics guidelines posted to its website. The NYSE and Nasdaq both have a phase-in rule that does not require a majority of the spin-off company’s board to be independent until one year after the listing date, and the NYSE has other phase-in rules regarding the independence of the spin-off company’s audit committee and compensation committee.

## **F. Investor Relations Activities**

In connection with a spin-off, it is often desirable to try to educate the investment community with respect to the company. Key time periods for approaches to the investment community should be identified and guidelines should be provided to assure compliance with securities law requirements. In the case of a spin-off preceded by an IPO, the blackout and waiting period requirements of a registered public offering will restrict the companies’ activities in this area, but Regulation FD will not be applicable to disclosures made in connection with the registered offering. A spin-off does not involve similar blackout and waiting period requirements, but the general antifraud provisions of the securities laws will still apply. In addition, Regulation FD will apply to disclosures that constitute material nonpublic information in connection with a spin-off, though materiality should be assessed relative to the parent prior to the

effectiveness of the spin-off company's Form 10. Discussions with investors and analysts should be consistent with publicly available information, including information contained in a publicly filed Form 10. Decisions will also need to be made as to the desirability and scope of "road show" activity (including the scope of investment banker assistance on the road show).

## VI.

### Tax Issues

#### A. Generally

##### 1. Requirements for Tax-Free Treatment

For a spin-off to qualify as tax-free to the parent and its shareholders for U.S. federal income tax purposes, it must qualify under Section 355 of the Internal Revenue Code. Section 355 aims to provide tax-free treatment to transactions that separate two operating businesses and not to transactions that resemble either (1) distributions of cash or other liquid assets or (2) corporate-level sales. This Part VI.A.1 discusses requirements under Section 355 that are intended to bolster the first goal, while Part VI.B below describes Section 355 requirements relating to the second goal.

Under Section 355, the parent must distribute “control” of the spin-off company (generally, stock representing 80% of the voting power and 80% of each non-voting class of stock) and must establish that any retention of stock or securities is not pursuant to a tax avoidance plan. In the spin-off, the parent can distribute stock, or stock and securities, of the spin-off company, and the distributees can be shareholders or shareholders and security holders. In addition, the parent and the spin-off company must each satisfy a five-year active trade or business test (*i.e.*, immediately after the spin-off, each of the parent and the spin-off company must be engaged in an “active trade or business” that was actively conducted throughout the five-year period before the spin-off, with certain exceptions). While there is no statutory requirement to maintain an “active trade or business” for a minimum time period post-spin, post-spin transactions, including dispositions of assets by either the parent or the spin-off company, must be analyzed to ensure they do not jeopardize satisfaction of the “active trade or business” requirement.

Further, the spin-off must be carried out for one or more corporate business purposes and not be used principally as a “device” for the distribution of the earnings and profits of the parent, the spin-off company, or both. Whether the spin-off is a “device” turns on whether the spin-off encompasses planned sales or exchanges of stock of the parent or spin-off company, or other transactions the effect of which would be to permit the distribution of corporate earnings without a dividend tax. This standard as to sales and exchanges may, in some cases, involve seeking representations by greater than five percent holders to the effect that such sales, exchanges or other distributions are not planned. In addition,

certain repurchases of the stock of the parent or spin-off company following the spin-off may implicate the “device” requirement. However, IRS ruling guidelines with respect to share repurchases are liberal, and generally, the repurchases will not be viewed as causing the distribution to be considered a “device” if (1) the repurchases are supported by a sufficient business purpose, (2) the repurchased shares are widely held, (3) the purchases are made in the open market and (4) at the time of the spin-off, there is no plan for the aggregate amount of repurchased shares to equal or exceed 20% of the relevant company’s outstanding shares.

The “business purpose” standard for a tax-free spin-off requires that a real and substantial non-tax purpose germane to the business of the parent, the spin-off company or both in fact motivated, in whole or substantial part, the spin-off. A shareholder purpose, such as increasing shareholder value, will not in and of itself suffice, although the IRS has held in published advice that a spin-off motivated by the desire to increase the stock price satisfies the business purpose requirement where that stock will be used to make acquisitions or compensate management. If more than one spin-off is to occur, each spin-off must be supported by its own business purpose(s).

Business purposes that can support a spin-off include demonstrably improving intended access to capital markets for the parent or the spin-off company (including enhancement of an initial carve-out IPO), allowing the parent or the spin-off company to have a “pure play” equity currency needed to make desired acquisitions or to attract or retain employees or better incentivize management, improving credit terms and enhancing “fit and focus” (*e.g.*, by allowing the management of the parent or the spin-off company to focus on its own strategic and operational plans without diverting human and financial resources to the other businesses and to pursue a capital structure or capital return policy that is most appropriate for its business and strategy).

In some cases, a parent having significant tax attributes, such as net operating losses or capital losses, may want a distribution to be partially taxable to the parent to “refresh” these attributes in the form of amortizable tax basis in the hands of the spin-off company. In some cases, it may be possible to trigger gain at the corporate level while preserving tax-free treatment to shareholders. For example, if the spin-off company distributes cash to the parent in excess of basis, the transaction is generally partially taxable to the parent.

Indeed, the reduced corporate federal income tax rate of 21% enacted in December 2017 mitigates the corporate-level tax that would be payable compared with the prior rate of 35% such that a taxable spin-off by a corporation that does not have net operating losses or capital loss carryforwards may be viable. If

properly structured, gain triggered on the distribution may result in the spin-off company having a valuable tax attribute in the form of amortizable tax basis in its assets.

As discussed further in Part VI.A.2, the IRS has taken steps to curb “cash-rich” spin-offs (or split-offs), where a very large percentage of the asset value of the parent or the spin-off company consists of nonbusiness assets (*i.e.*, cash or other liquid or inactive assets, including a non-controlling stake in another publicly traded entity). In 2016, the IRS proposed regulations that, if finalized, would prevent certain such transactions from qualifying for tax-free treatment. Such regulations would require each active business relied upon by each of the parent and the spin-off company to represent at least five percent of the total asset value of the respective company.

In August 2022, the Inflation Reduction Act enacted (i) a tax on repurchases of stock of publicly traded U.S. corporations (other than REITs and regulated investment companies) (the “Excise Tax”) and (ii) a 15% corporate alternative minimum tax (“CAMT”). The Excise Tax is equal to one percent of the fair market value of the repurchased stock (less the fair market value of stock issued by the corporation) during a taxable year. CAMT is imposed on the “adjusted financial statement income” (“AFSI”) of U.S. corporations (other than S corporations, REITs, and regulated investment companies) with average AFSI in excess of \$1 billion over the preceding three-year period. In December 2022, the IRS issued guidance that generally confirms that neither the Excise Tax nor CAMT should result in the imposition of tax on spin-offs or split-offs that are otherwise tax-free transactions to the parent and its shareholders for U.S. federal income tax purposes.

## **2. Procedural Considerations**

A company planning a spin-off must determine whether to proceed solely on the basis of an opinion of tax counsel or whether to seek a private letter ruling from the IRS. A private letter ruling provides a high degree of assurance as to the tax results of the issues ruled upon, which may include aspects of internal restructuring steps that precede a spin-off or split-off.

Depending on the complexity of the transaction structure, the preparation of a ruling request could take several weeks or months, as the ruling request includes detailed information regarding the entities and businesses involved. Often, a ruling request will request rulings as to numerous internal pre-spin restructuring steps, thus lengthening the process of preparing the ruling request and obtaining the ruling once the request has been submitted as compared with

seeking only rulings on the spin-off itself. Typically, supplemental submissions in addition to the initial submission of the ruling request are required, both to respond to questions and issues raised by the IRS and to update the IRS with respect to the status of the relevant transactions and any changes in the transaction structure.

Depending on the complexity of the request, the process of obtaining a ruling has, in recent years, taken approximately six months from the date of submission. However, in January 2022, the IRS established a pilot program permitting taxpayers to request expedited handling of private letter ruling requests through a “fast-track” process. The “fast-track” pilot program became permanent in July 2023. If the IRS grants a request for “fast-track” processing, it will generally endeavor to complete its review of the ruling request, and, if appropriate, issue the ruling, within 12 weeks after the request is assigned to an IRS review team. A taxpayer can request that the IRS process its ruling request within a period shorter than 12 weeks if certain additional requirements are satisfied, including demonstrating that there is a business exigency outside the taxpayer’s control necessitating faster processing and there will be adverse consequences if the IRS does not accommodate the request. Ruling requests involving particularly complex transaction structures or legal issues, while eligible for “fast-track” processing, may be subject to a review period longer than 12 weeks. A company planning a spin-off will need to consider the timing benefit afforded by the “fast-track” process in the context of the anticipated overall timeline to complete the transactions that are the subject of the ruling. In some cases, utilizing the “fast-track” process will not be necessary if the relevant transactions are expected to require a significant period of time to implement. Further, it is often beneficial to receive a ruling closer to the time of implementation of the relevant transactions, when the facts on which the ruling is based are less likely to change. The “fast-track” process may be helpful in situations where a company initially determines to proceed solely on the basis of an opinion of tax counsel but subsequently determines to seek a ruling, based on later factual or legal developments, at a time when the spin-off is closer to completion.

The IRS has strict and sometimes unpredictable ruling guidelines. There is generally no assurance that a favorable ruling can be obtained, although a pre-submission conference with the IRS (which is typically optional, but required for “fast-track” processing), as well as discussions with the IRS while the ruling request is pending, provide feedback. The IRS has over time changed the scope of spin-off related private letter rulings that it will grant. For several years, the IRS would not rule broadly on whether a transaction as a whole satisfied the requirements for tax-free treatment, and instead would only rule on “significant



issues” embedded in the transaction. However, the IRS subsequently revised its “no-rule” policy and has eliminated “significant issue” rulings, now only ruling on the qualification of a transaction as a whole for tax-free treatment. The IRS will not rule, however, on whether the “business purpose” requirement has been satisfied but may rule on legal issues related to the “business purpose” requirement, provided such issues are not inherently factual in nature.

As discussed above in Part III.B, in 2018, the IRS issued guidance pursuant to which it will issue private rulings on the tax treatment of the assumption or satisfaction of indebtedness of the parent in connection with spin-offs, including (i) debt-for-debt exchanges, (ii) debt-for-equity exchanges, (iii) the use of cash proceeds of new debt of the spin-off company to repay parent debt, and (iv) the assumption of parent debt by the spin-off company. Taxpayers requesting such rulings must comply with the terms of such IRS guidance, including by submitting to the IRS representations, information, and analysis with respect to the transaction(s) with respect to which a private ruling is sought. Among other requirements, other than in certain situations involving the refinancing of historic parent debt in anticipation of the spin-off, the parent’s debt that is assumed or satisfied in connection with the spin-off must have been issued before the request for an IRS private ruling is submitted and no later than 60 days before the earliest of (x) the date of the first public announcement of the spin-off, (y) the date on which the parent enters into a binding agreement to engage in the spin-off and (z) the date on which parent’s board of directors approves the spin-off. Further, the satisfaction of parent debt must occur within 30 days after the spin-off (or, if there are substantial business reasons for any delay, within 180 days after the spin-off). Recently, the IRS has informally indicated its intent to scrutinize more closely spin-offs involving debt-for-debt or debt-for-equity exchanges where the parent debt being repaid is newly-incurred in connection with the spin-off and the proceeds of the new parent debt are used to repay historic parent debt.

Absent unique and compelling reasons, the IRS will no longer issue rulings as to the tax-free treatment of a spin-off if the fair market value of the gross assets of the “active trade or business” on which either company is relying is less than five percent of the total fair market value of the gross assets of the company. Historically, the IRS would not issue rulings as to the tax-free treatment of certain “cash-rich” spin-offs (or split-offs). Specifically, the IRS would not rule if (1) the value of the investment assets held by either the parent or the subsidiary was at least two-thirds of the value of its total gross assets, (2) the value of the active trade or business of either company was less than 10% of the value of its investment assets and (3) the ratio of the value of investment assets to non-investment assets of either company was at least three times such ratio of the

other. This appeared to lead Yahoo! to abandon its plans for a tax-free spin-off of a company that would hold its stake in Alibaba. However, in January 2024, the IRS removed its “no rule” policy with respect to “cash-rich” spin-offs (or split-offs) and has informally indicated its expectation to issue revised guidance in this area.

In connection with obtaining an IRS ruling, the parent will be required to comply with certain procedural requirements and make certain representations with respect to the transaction under penalties of perjury. An opinion of tax counsel will similarly rely upon representations made by an officer of each of the parent and the company to be spun off.

## **B. Spin-Offs Followed by Acquisitions**

As described above in Part VI.A, certain requirements for tax-free treatment under Section 355 are intended to avoid providing preferential tax treatment to transactions that resemble corporate-level sales. Under current law, a spin-off coupled with a tax-free or taxable acquisition will cause the parent to be taxed on any corporate-level gain in the spin-off company’s stock if, as part of the plan (or series of related transactions) encompassing the spin-off, one or more persons acquire a 50% or greater interest in the parent or the spin-off company. Acquisitions occurring either within the two years before or within the two years after the spin-off are presumed to be part of a plan or series of related transactions with the spin-off. IRS regulations include facts and circumstances tests and safe-harbors for determining whether an acquisition and spin-off are part of a plan or series of related transactions.

A detailed explanation of the tax considerations relevant to post-spin strategic transactions is attached as Annex B. Generally, where there have been no “substantial negotiations” with respect to the acquisition of the parent or the spin-off company or a “similar acquisition” within two years before the spin-off, an acquisition of the parent or the spin-off company for acquiror stock after the spin-off will not jeopardize the tax-free nature of the spin-off. Substantial negotiations generally require discussions of significant economic terms. In general, an actual acquisition is “similar” to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business assets as the potential acquisition would have.

Post-spin equity transactions that are part of the plan remain viable where the historic shareholders of the parent retain a greater than 50% interest (by vote and value) in the parent and the spin-off company after the merger transaction. Thus, a spin-off followed by a merger with a smaller company is feasible even if

it is part of a plan or series of related transactions with the spin-off and has been the format of a number of significant recent transactions, as discussed in Part II.B. Where the merger partner is larger than the parent or spin-off company to be acquired, it may be possible to have the merger partner borrow funds to redeem or otherwise shrink its capitalization before the merger transaction. As well, overlapping shareholders can facilitate satisfaction of the 50% test. That is, if two parent corporations have sufficient overlapping shareholders, it may be possible for each of them to spin-off a subsidiary and then for the two subsidiaries to merge. By the same token, with sufficient overlapping shareholders, it may be possible for two parent corporations to merge and for the combined company then to distribute a spin-off company containing assets or businesses historically owned by each of the two parent corporations. An example is the merger of Dow and DuPont in 2017 and the separation of the combined company into three publicly traded companies.

Because post-spin transactions can cause the spin-off to become taxable to the parent (and potentially its shareholders), tax matters agreements impose restrictions with respect to such transactions and allocate any corporate tax liability resulting from the spin-off to the corporation the acquisition of whose stock after the spin-off triggered the tax, as described above in Part IV.D.



## VII.

### **Listing and Trading Considerations**

#### **A. Stock Exchange Listing**

The parent and the company to be spun off will need to decide on which exchange(s) to list the spin-off company's stock after the spin-off. A listing application with the exchange(s) chosen should then be filed shortly after the initial filing of the Form 10 with the SEC (or the Form S-1, in the case of a spin-off preceded by an IPO). Approval for listing upon notice of issuance should be obtained before the spin-off (or, if applicable, before closing the public offering) and will typically be a condition of closing. A certification of approval for listing is typically filed by the stock exchange with the SEC in connection with the spin-off company's request for the accelerated effectiveness of the registration statement.

#### **B. "When-Issued" Trading**

Typically, a company will seek to smooth the transition to post-spin trading of the shares of the parent and the spin-off company by establishing multiple trading markets. At the parent level, this involves two markets in shares of parent common stock: a "regular-way" market and an "ex-distribution" market. The parent shares that trade on the "regular-way" market trade with an entitlement to the shares of the subsidiary to be distributed in the spin-off. The parent shares that trade on the "ex-distribution" market trade without an entitlement to shares of the subsidiary to be distributed in the spin-off.

During this same period, there is a "when-issued" market in the shares of the subsidiary to be distributed in the spin-off. "When-issued" trading refers to a sale or purchase made conditionally because the security has been authorized but not yet issued. The "when-issued" trading market is a market for the shares of the spin-off company, which allows parent shareholders to trade their entitlement to shares of the spin-off company without shares of the parent.

If the spin-off is conditioned on obtaining a regulatory approval or on another transaction that is itself conditioned on an event outside the parties' control, such as a merger or other M&A transaction that requires shareholder or regulatory approval, then the stock exchange generally will not allow "when-issued" trading to begin until after the required approval has been obtained. In addition, note that stock exchange rules may require a parent that pays cash

dividends to coordinate the record date for such a dividend with the when-issued period for a spin-off.

**C. The Distribution Ratio**

The distribution ratio is the number of shares of the spin-off company to be distributed in respect of each share of parent common stock in the spin-off. The distribution ratio is determined by the parent's board of directors, in consultation with management and its financial advisor, and is typically based on the target share price for the spin-off company.

**D. Reverse Stock Splits**

If the subsidiary being spun off comprises a significant portion of the value of the parent, the spin-off likely will result in a substantial decrease in the stock price of the former parent. A parent may implement a reverse stock split to move the per-share trading price of its stock back towards the pre-spin level. A reverse stock split is commonly effected by a series of amendments to the parent's certificate of incorporation, which, depending on state law, typically require a shareholder vote.

## ANNEX A

### ILLUSTRATIVE SAMPLE TIMETABLE FOR A SPIN-OFF<sup>1</sup>

	One Month Prior to Board Meeting	Board Meeting	Weeks 1-2 After Board Meeting	Week 3-4 After Board Meeting	Weeks 5-9 After Board Meeting	Week 10-13 After Board Meeting	Weeks 14-18 After Board Meeting	Weeks 19-25 After Board Meeting	Weeks 26-29 After Board Meeting
Review separation-related issues									
Determine what financial statements will be required									
Parent board meeting to give preliminary approval									
Notify Parent stock exchanges and issue Parent press release									
File Form 8-K for Parent									
Commence/continue preparing information statement and Form 10									
Commence drafting separation agreements									
Begin preparing organizational documents for Spinco									
File Form 10 with the SEC									
Receive and respond to SEC comments									
File forms of documents as exhibits to the Form 10									
File preliminary listing application(s)									
Spinco executes agreements with transfer agent and registrar									
Clear all outstanding SEC comments									
Receive notice of approval for listing from securities exchange									
Receive solvency opinion									
Parent and Spinco final board meetings									
<b>Form 10 declared effective by the SEC</b>									
File Form 8-K and issue press release for Parent									
Deliver final information statement to Parent shareholders									
"When-issued" trading									
<b>Distribution date and closing of spin-off</b>									
Parent and Spinco execute spin-off documents									
Issue Parent and Spinco press releases and file 8-Ks regarding closing									
File Form 3 and Form 4									

<sup>1</sup> This illustrative timetable is for a spin-off that is not preceded by an IPO.

## Times and Actions

<i>Period/Event</i>	<i>Action</i>
Initial Consideration of Potential Transaction	Establish team consisting of key personnel from the parent (“Parent”) and, if appropriate, the spin-off company (“Spinco”) to review and resolve principal issues.
[minimum of one month before Initial Approval Board Meeting]	<p>Review separation-related issues, including:</p> <ul style="list-style-type: none"><li>– identification of assets to be spun off;</li><li>– determination of capital structure, liquidity requirements and availability of financing, particularly with respect to any new financing arrangements to be entered into in connection with the spin-off (<i>e.g.</i>, to pay a pre-spin dividend to Parent);</li><li>– allocation of debt and other liabilities;</li><li>– corporate structure, including the Spinco jurisdiction of incorporation;</li><li>– consent requirements, including with respect to Parent and Spinco material contracts and financing arrangements;</li><li>– solvency of Parent and Spinco following the spin-off (including whether to seek a third-party solvency opinion) and evaluation of contingent liabilities;</li><li>– availability of surplus for spin-off distribution under applicable law;</li><li>– identification of Spinco senior management;</li><li>– board size and composition (including search process for director candidates);</li><li>– if relevant, evaluation of interlocks among Parent and Spinco directors and officers;</li><li>– employee and management compensation issues, including treatment of benefit plans and employment arrangements;</li><li>– identification of necessary intercompany arrangements post-spin (<i>e.g.</i>, shared services, technology sharing, intellectual property licenses and commercial arrangements);</li><li>– determination of whether tax opinion or a combination of tax opinion and IRS ruling will be relied upon (and initial diligence regarding tax-free treatment);</li><li>– initial analysis of internal tax and corporate restructuring to</li></ul>



<i>Period/Event</i>	<i>Action</i>
	<p>effect separation in tax-efficient manner;</p> <ul style="list-style-type: none"> <li>– determination of any required regulatory filings;</li> <li>– potentially commence preparation of information statement and Form 10; and</li> <li>– corporate name for each entity and right to use Parent name.</li> </ul> <p>Determine what historical financial statements and pro forma financial statements will be required for Form 10 purposes and commence preparation. In any event, prepare standalone financial statements for Spinco and Parent (including allocation of existing goodwill and identification of reserves and transaction costs).</p> <p>Consider projected dividend levels for Spinco, if any.</p> <p>Develop public and investor relations plan, including plan for presentations to:</p> <ul style="list-style-type: none"> <li>– institutional investors;</li> <li>– existing lenders;</li> <li>– rating agencies;</li> <li>– employees;</li> <li>– customers and suppliers; and</li> <li>– governmental and regulatory bodies.</li> </ul> <p>Develop a strategy for communicating with Spinco employees regarding future benefits arrangements and Parent regarding effects of spin-off on remaining Parent employees.</p> <p>Prepare board information package, draft board resolutions, management presentations and information concerning contingent liabilities.</p>
Board Meeting for Initial Approval	<p>Parent Board meeting to discuss and give preliminary approval of spin-off, subject to final board approval, and authorize Parent management to proceed with preparation therefor. Board meeting to include presentations from Parent management (including with respect to pro forma financial statements and adequacy of surplus), internal and/or outside counsel, and, if desirable, solvency expert and financial advisor.</p>

<i>Period/Event</i>	<i>Action</i>
	<p>Notify Parent stock exchanges and issue Parent press release.</p> <p>File Form 8-K for Parent.</p>
Weeks 1–2 After Board Meeting	<p>Consider commencing public investor relations plan.</p> <p>Commence/continue preparation of information statement and Form 10.</p> <p>Continue preparation of financial statements and MD&amp;A for Form 10 purposes. Consider impact of spin-off on Parent financial statements.</p> <p>Commence drafting separation and distribution agreement, employee matters agreement, tax matters agreement, transition services agreement and other agreements concerning the relationship between Parent and Spinco, if applicable, such as intellectual property arrangements (the “Spin-off Documents”).</p> <p>Determine projected dividend levels for Spinco.</p> <p>Determine on which exchange(s) Spinco will be listed.</p> <p>Prepare and distribute questionnaire to directors and officers of Spinco, if determined.</p> <p>Survey of regulatory filings and approvals. Retain local counsel where necessary.</p> <p>Reserve Spinco name in proposed state of incorporation and elsewhere, as necessary, as well as stock exchange ticker symbol.</p> <p>Parent and Spinco to review any required new lending relationships for Spinco and general liquidity requirements.</p> <p>Commence process of seeking any required third-party consents.</p> <p>Preliminary contact with rating agencies.</p>

<i>Period/Event</i>	<i>Action</i>
Weeks 3–4 After Board Meeting	<p>Distribute drafts of the separation and distribution agreement and any other Spin-off Documents that will need to be considered by larger groups. Certain agreements that will involve smaller working teams may proceed on separate tracks.</p> <p>Distribute drafts of historical financial statements and MD&amp;A, if practicable.</p> <p>Begin preparing organizational documents and corporate documents for Spinco. Charter and bylaws take precedence as they ultimately will need to be filed with the Form 10; committee charters, policies, etc., can proceed on a separate track.</p>
Weeks 5–9 After Board Meeting	<p>Drafting sessions for information statement and Form 10.</p> <p>Finalize financial statements and MD&amp;A for Form 10 purposes.</p> <p>Submit ruling request with IRS if ruling is to be sought.</p> <p>Continue drafting Spin-off Documents.</p> <p>Determine the treatment of any tax-qualified retirement plans.</p> <p>Begin drafting employee benefit and equity plans for Spinco.</p> <p>Consider blue sky issues.</p> <p>File Form 10 with the SEC.</p> <p>Issue press release regarding filing, if desired.</p>
Weeks 10–13 After Board Meeting	<p>Receive and respond to SEC comments.</p> <p>Continue drafting Spin-off Documents. File forms of material agreements, when ready, as exhibits to the Form 10.</p> <p>Finalize employee benefit and equity plans for Spinco.</p> <p>Begin confidential discussions with applicable stock exchange</p>

<i>Period/Event</i>	<i>Action</i>
	<p>regarding listing application process and draft preliminary listing application(s) and other documents relating to exchange listing.</p> <p>Obtain third-party consents and state and foreign regulatory approvals.</p> <p>Negotiate bank and/or other credit facilities with lenders.</p> <p>Engage and negotiate agreements with distribution agent for the spin-off and transfer agent for Spinco stock post-spin.</p> <p>Begin preparation of resolutions for Parent, Spinco and subsidiary boards of directors authorizing transfers of assets and related matters.</p>
Weeks 14–18 After Board Meeting	<p>Receive and respond to additional SEC comments.</p> <p>Finalize Spin-off Documents. File forms of documents as exhibits to the Form 10.</p> <p>File preliminary listing application(s) with applicable exchanges.</p> <p>Prepare registration statements for employee equity plans of Spinco.</p> <p>Spinco executes agreements with transfer agent and registrar in form satisfactory to the securities exchanges on which Spinco intends to list.</p> <p>Establish eligibility of Spinco common stock with DTC.</p>
Weeks 19–25 After Board Meeting	<p>Receive and respond to additional SEC comments. Clear all outstanding comments.</p> <p>Receive notice of approval for listing from securities exchange.</p> <p>Receive solvency opinion with respect to solvency of Spinco following the spin-off. Solvency firm may give a bring-down</p>

*Period/Event*

*Action*

opinion at closing.

Parent and Spinco boards of directors or authorized committees meet to approve the following (to the extent not previously approved):

- authorize distribution of Spinco common stock to Parent shareholders, distribution ratio and method of handling fractional shares;
- set record and distribution dates for stock dividend effecting spin-off and declare spin-off dividend;
- appoint distribution agent;
- designate an officer or committee of Parent with power to approve all matters in connection with the proposed distribution, if desired;
- receive updated reports from experts if needed
- elect Spinco directors and officers;
- approve Spinco charter and bylaws and adopt any related board or shareholder resolutions;
- authorize transfers of assets and liabilities, if necessary;
- approve form of separation and distribution agreement and other Spin-off Documents;
- ratify Form 10; authorize execution and delivery of the other securities law-related documentation; appoint attorney-in-fact to sign the registration statements required for Spinco employee benefit plans; and authorize other customary securities law matters relating to the spin-off;
- approve form and authorize execution and delivery of various agreements concerning credit lines and debt agreements, if applicable;
- appoint transfer agent and registrar acceptable to applicable stock exchanges on which listing will be made;
- authorize compliance with blue sky laws as required and adopt resolutions concerning blue sky authorities;
- authorize listing of Spinco common stock;
- authorize name changes and filings to effectuate them;
- approve employee benefits, stock option and other incentive compensation and benefit plans of Spinco; and

<i>Period/Event</i>	<i>Action</i>
	<p>– authorize all steps previously taken and the taking of all further steps in connection with the spin-off.</p> <p>Submit request for acceleration of Form 10 effectiveness.</p> <p><b>Form 10 declared effective by the SEC.</b></p> <p>File blank Forms 3 for Parent (as shareholder of Spinco) and current executive officers and directors of Spinco on day the Form 10 is declared effective.</p> <p>File Form 8-K and issue press release for Parent.</p> <p>File registration statement(s) regarding Spinco employee equity plans.</p> <p>Continue investor relations plan with respect to the spin-off.</p> <p>Finalize Spinco’s bank and other credit facilities.</p> <p>Give notice of record and distribution dates to transfer agent and distribution agent.</p> <p>Print and mail final information statement to Parent shareholders, or post information statement online and mail notice of availability to Parent shareholders.</p> <p>File any necessary name changes in appropriate states.</p>
Weeks 26–29 After Board Meeting	<p><b>Receive opinion of tax advisors and, if applicable, IRS ruling.</b></p> <p>“When-issued” trading market commences.</p> <p><b>Distribution date and closing of spin-off.</b></p> <p>Parent and Spinco execute Spin-off Documents.</p> <p>Issue Parent and Spinco press releases and file Parent and Spinco Forms 8-K regarding closing. (Spinco 8-K typically includes</p>

*Period/Event*

*Action*

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executed versions of the material Spin-off Documents.)

Notify distribution agent and other required parties of closing.

Distribute stock of Spinco to Parent shareholders and implement approved mechanism for handling fractional shares on distribution date.

File Form 3 for executive officers and directors of Spinco appointed at the closing of the spin-off. File Form 4 for Parent reflecting disposition of Spinco stock in the distribution on record date.

File final securities exchange listing applications, if required by exchange.





## ANNEX B

### POST-SPIN LIMITATIONS ON STRATEGIC TRANSACTIONS

As described in Part VI.B above, when a parent spins off a subsidiary in a tax-free transaction, the tax rules impose certain restrictions on subsequent acquisitions of the parent or the spin-off company. The following chart summarizes these restrictions and is followed by additional explanation and discussion. The summary chart is for ease of reference only and should be read in conjunction with the discussion that follows it.

<b>Circumstances</b>	<b>Acquisition of 50% or more of the parent or the spin-off company in stock transaction</b>	<b>Acquisition of 50% or more of the parent or the spin-off company in all or part cash transaction</b>
No agreement or “substantial negotiations” with respect to acquisition or a “similar acquisition” (see below) within two years before completion of spin-off	No post-spin waiting period	Facts and circumstances test as to whether spin-off is a “device” to distribute earnings (see below)
Spin-off motivated by valid business purpose, and no agreement or “substantial negotiations” with respect to acquisition or a “similar acquisition” within one year before completion of spin-off	Six-month post-spin waiting period	Six-month post-spin waiting period, plus facts and circumstances test (see above)
Substantial negotiations within one year before spin-off, but no agreement, understanding or arrangement concerning the acquisition or a “similar acquisition” at the time of the spin-off	One-year post-spin waiting period	One-year post-spin waiting period, plus facts and circumstances test (see above)

“Substantial negotiations” generally require discussions of significant economic terms (*e.g.*, price or exchange ratios). For this purpose, actions of officers, directors, controlling shareholders and any other persons acting with the implicit or explicit permission of such officers, directors or controlling shareholders are taken into account.

In general, an actual acquisition is “similar” to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business assets as the potential acquisition would have.

Under the “device” rules, a spin-off is taxable at the corporate level and at the shareholder level if the spin-off is principally a device for the distribution of earnings and profits (*i.e.*, if the spin-off is principally a means to get cash to shareholders at capital gains rates). The “device” rules are discussed below.

## **Discussion**

### **I. Section 355(e) Rules**

Under the “anti-Morris Trust” rules of Section 355(e) of the Internal Revenue Code, a spin-off is taxable at the corporate level (although not at the shareholder level) if the spin-off is part of a “plan” that includes the acquisition of 50% of the vote or value of the parent or the spin-off company.

- Under the statute, a spin-off and an acquisition of stock are presumed to be part of a plan if the acquisition occurs within two years before or after the spin-off.
- Under regulations, an acquisition of stock of the parent or the spin-off company within two years after the spin-off will not be deemed to be part of a plan if:
  - There was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar acquisition” **within the two-year period ending on the date of the completion of the spin-off; OR**
  - The spin-off was motivated in whole or substantial part by a corporate business purpose other than to facilitate an acquisition of, or issuance of stock by, the acquired company (the parent or the spin-off company), and there was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar

acquisition” during the period that **begins one year before the spin-off and ends six months after the completion of the spin-off**; OR

- There was no agreement, understanding or arrangement concerning the acquisition or a “similar acquisition” **at the time of the spin-off** AND there was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar acquisition” **within one year after the completion of the spin-off**.

## II. “Device” Rules

Under the “device” rules, a spin-off is taxable at the corporate level and at the shareholder level if the spin-off is principally a device for the distribution of earnings and profits (*i.e.*, if the spin-off is principally a means to get cash to shareholders at capital gains rates).

- A sale or exchange of stock of the parent or the spin-off company following a spin-off is evidence of device, except in the case of an exchange pursuant to an all-stock acquisition that is generally tax-free. Thus, the “device” rules come into play in the context of a spin-off followed by a cash acquisition (or an acquisition for cash and stock). Generally, the shorter the period between the spin-off and the sale, the stronger the evidence of device. A post-spin acquisition of the parent or the spin-off company by a foreign acquiror, even pursuant to an all-stock transaction, raises complex tax issues and may implicate the “device” rules.
- A post-spin sale or exchange that was discussed by the buyer and the seller before the spin-off and was reasonably to be anticipated by both parties will ordinarily be considered “substantial” evidence of device.
- Absence of accumulated earnings and profits is evidence of non-device.