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Top Ten Corporate Actions of 2009

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Capital Changes

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Introduction

How the list was compiled

- We received input from members of securities industry
- We also considered events that
 - Were especially challenging or unusual
 - Illustrated common problems
 - Were widely held

What to expect from this presentation

- We will focus on top 4 transactions and summarize remaining 6
- We will leave time to respond to questions
- Questions may be submitted in writing at any time during presentation by typing in the LiveMeeting “Questions and Answers” textbox

Top Ten for 2009

Companies whose corporate actions were most challenging/interesting:

1. Schering-Plough Corp./Merck & Co., Inc.
2. Banco Santander SA
3. Walter Industries, Inc.
4. Brasil Telecom Participacoes SA
5. Wyeth/Pfizer, Inc.
6. Rio Tinto plc/Rio Tinto Ltd.
7. Time Warner, Inc.
8. Pengrowth Energy Trust
9. Tim Hortons, Inc.
10. Orezone Resources, Inc.

Schering-Plough

- Acquisition of Schering-Plough by Merck
 - Unusual structure to preserve Johnson & Johnson joint venture
- Schering-Plough creates 2 merger subsidiaries
 - One sub merges into Schering-Plough, which is renamed Merck (New)
 - Another sub merges into old Merck, which becomes sub of Merck (New)
 - Merck merger is one-for-one nontaxable exchange
 - Merger is Sec. 368(a) reorganization; basis and holding period carry over
- Schering Plough merger; shareholder receives
 - 0.5767 share Merck & Co., Inc. (New) common
 - AND
 - \$10.50 cash
 - Treated as retention of 0.5767 share Schering-Plough (New Merck) and exchange of 0.4233 share Schering-Plough for \$10.50 cash

Schering-Plough (continued)

- Exchange of portion of share for cash treated as **partial redemption** of Schering-Plough stock
- Sec. 302 rules apply to redemptions (exchange vs. dividend)
 - If corporation redeems its stock in exchange for property (cash), redemption treated as distribution in exchange for stock if **one** of these tests met
 1. Not essentially equivalent to a dividend or
 2. Substantially disproportionate with respect to the shareholder or
 3. In complete termination of shareholder's interest in corporation or
 4. In redemption of stock held by individual shareholder, and in partial liquidation of the distributing corporation
 - Analysis is at shareholder level (except for test 4) based on specific facts and circumstances; complex constructive ownership rules apply
- If 302 rules satisfied, redemption treated as exchange
 - Capital gain/loss = difference between cash received and basis
- If 302 test not satisfied, treated as dividend (to extent of Schering-Plough current and accumulated earnings and profits)

Schering-Plough (continued)

- Company states substantially disproportionate test of 302 satisfied if Schering-Plough shareholder has **NO** actual or constructive ownership of Merck common
 - Substantially disproportionate
 - If after redemption holder owns less than 50% of combined voting power **AND**
 - ratio of ownership of total voting stock less than 80% of what it was before redemption **AND** meets same 80% test for all common stock of corporation
 - New Merck stock to Old Merck shareholders in merger reduces Schering-Plough percentage ownership of New Merck (Old Schering-Plough)
 - About 32% of New Merck owned by Schering-Plough shareholders
 - Result is exchange treatment
- Schering-Plough shareholder actually or constructively owning Merck common may still satisfy a 302 test

Banco Santander

- Scrip dividend - Oct 15 investors receive one subscription right for every share held. Rights trade Oct 16-30
- Three options for disposing of subscription rights
 - Cash (fixed price formula): rights are sold back to company, at a fixed price (0.12 euro based on fixed formula). Spanish withholding tax applies. ADR holders also pay a fee, proceeds are converted into USD.
 - Cash (sale in market place): rights are sold in euros in Spanish market, Oct 28-30. No Spanish withholding tax applies. ADR holders also pay a fee, proceeds are converted into USD.
 - Conversion into shares or ADRs: On Oct 30, based on fixed formula. Cash paid for fractions. No Spanish withholding tax. ADR holders also pay a fee.
- Shareholder elections for this dividend (including default elections) apply to future dividends that offer same terms, unless company is otherwise notified.

Banco Santander - U.S. Taxability

- U.S. tax opinion is vague on several points, but based on structure of the transaction and matters addressed by company, following should apply:
- Treat receipt of subscription right as qualified dividend equal to FMV
 - 0.12 euro based on company formula or 0.1255 euro based on traded value
 - Basis of subscription rights equals FMV on date of receipt (Oct 15)
 - Holding period begins next day (Oct 16)
- Disposition of subscription rights probably treated as follows:
 - Fixed price option - Treat gross amount of distribution as dividend, i.e. USD value of 0.12 euro received, no deduction for Spanish tax withheld or ADR fee assessed
 - Market price option - Sale of rights results in capital gain or loss
 - Conversion of rights into new shares/ADRs - Should not be taxable. Basis of new shares equals FMV of rights. Converted shares have separate holding period. Cash for fractions results in capital gain or loss.
- Issues:
 - Determining FMV of rights (fixed price vs. market price)
 - Dividend equals gross amount of distribution. No deduction for withholding tax or fees
 - Spanish tax withheld may entitle holder to possible foreign tax credit
 - Foreign currency gain or loss (not enough information)
 - How to treat fees paid (reduce amount of gain, increase basis of new or existing shares/ADRs)?
 - When does holding period for new shares begin (Oct 16 or Oct 30)?

Banco Santander - U.K. Taxability

- Option 1 - Cash payment should generally be treated as a capital distribution rather than as dividend income.
 - Amount of capital distribution equals sum of cash payment and Spanish withholding tax deducted from the payment

- Option 2 - Cash payment should be treated as a capital distribution rather than as dividend income.
 - Amount of capital distribution equals cash payment received.

- Option 3 - Receipt of additional Santander shares should not give rise to taxable income or to a disposal for purposes of taxation of chargeable gains.
 - New shares treated as part of the same asset as your existing holding of Santander shares, with any base cost in your existing Santander shares being apportioned between your existing shares and your new Santander shares.

Walter Energy, Inc. (formerly Walter Industries)

- Spins off Walter Investment Management LLC
 - 1 Walter Investment Management LLC interest
 - Originally known as JWH Holdings or Spinco
 - Tax-free distribution
- LLC then distributes dividend to Walter Energy shareholders
 - 0.296 LLC interest
 - or
 - \$1.51 cash
 - Cash election prorated
- LLC merges into Hanover Capital Mortgage Holdings (REIT) renamed Walter Investment Management Corp.
 - 0.299 share Walter Investment per LLC interest
 - Merger itself is nontaxable
 - LLC interests exchanged for Walter Investment from spin-off and dividend
 - Nontaxable spin-off
 - Taxable cash/stock election dividend

Walter Energy, Inc. (continued)

- Spin-off of LLC interests was nontaxable
 - Basis allocated 87.56% Walter Energy; 12.44% to Walter Investment Management Corp. common received in spin-off
 - Holding period carries over
- Dividend of LLC interests was taxable
 - Basis of Walter Investment Management common received from dividend is \$13.80 per share (determined by company, not trading prices)
 - Valuation assessment based on assets/liabilities, outstanding shares
 - New holding period
- If LLC interests elected for dividend
 - 22.86% of Walter Investment common from taxable dividend
 - 77.14% from nontaxable spin-off
- If cash elected for dividend (prorated)
 - 18.06% from taxable dividend
 - 81.94% from nontaxable spin-off
 - And cash

Brasil Telecom Participacoes SA

- Reorganization of Brasil Telecom Participacoes and Brasil Telecom into Telemar, accomplished in three consecutive steps:
 - First merger of Brasil Telecom Participacoes into Brasil Telecom (completed 11/11/2009)
 - Mandatory exchange of Brasil Telecom shares for shares of Coari Participacoes (vote postponed pending SEC registration)
 - Final merger of Coari into Telemar (not scheduled)
- Terms of first merger:
 - Per share Brasil Telecom Participacoes common: 1.2190981 shares Brasil Telecom common
 - Per share Brasil Telecom Participacoes preferred: 0.1720066 share Brasil Telecom common and 0.9096173 share Brasil Telecom preferred
 - Per Brasil Telecom Participacoes ADR: 0.860033 Brasil Telecom ADR representing common and 1.516028 Brasil Telecom ADR representing preferred
 - Cash paid for fractions
- Telebras HOLDRs
 - Originally represented 12 Telebras companies
 - Distributed Brasil Telecom ADS (removed as a constituent company)
 - HOLDR now represents only TIM Participacoes and Vivo

Brasil Telecom Participacoes SA - U.S. Taxability

- Company assumes three steps (first merger, mandatory exchange and final merger) constitute single, integrated transaction
- *If* all steps are completed, and *If* company is correct that this is an integrated transaction, *Then*
- Step one - First merger is taxable:
 - Results in capital gain or loss. Compare value of shares/ADRs, plus cash for fractions, with basis of shares/ADRs surrendered
 - FMV of Telecom common = approximately \$15.83
 - FMV of Telecom preferred = approximately \$10.13
 - FMV of Telecom ADR representing common = \$16.725
 - FMV of Telecom ADR representing preferred = \$31.315
 - Basis of Telecom shares/ADRs equals FMV
 - Holding period begins on day after merger completion
- Step two - Mandatory exchange will also be taxable ... but may be nontaxable for some shareholders
- Step three - Nothing disclosed yet (stay tuned)

Time Warner Inc.

- Separation of Time Warner Inc. and Time Warner Cable Inc.
- Time Warner Cable (March 12)
 - Pays \$10.27 special cash dividend; then immediately
 - Converts class A common to common and reverse splits 1-3
 - 30% to 35% of dividend estimated to be return of capital
- Time Warner Inc.
 - spins off its Time Warner Cable common March 12
 - stock held by agent and not paid until March 27
 - Time Warner Inc. common reverse splits common 1-3 on March 27
- Time Warner Cable stock held prior to spin-off
 - Cash distribution causes basis adjustment for return of capital
 - No adjustment to Cable stock received in spin-off; no cash distribution

Other Challenging International Corporate Actions

- Rio Tinto plc/Rio Tinto Ltd.
 - Rights offering. For Rio Tinto Ltd. unclear how many rights issued per share
 - Basis allocation: Plc rights (15.2397%), Ltd. rights (probably 21.7711%)
 - Mandatory allocation if rights sold or exercised
 - ADR holders (Plc) received proceeds and therefore must allocate basis
- Pengrowth Energy Trust
 - Partnership elected to be reclassified as corporation for U.S. tax purposes
 - Deemed contribution: Transfer of all partnership assets, subject to all its liabilities, in exchange for stock of new corporation (applied proportionally to each investor)
 - Basis of new “stock” equal to adjusted basis in Pengrowth units, increased by gain recognized in deemed contribution
 - May be more than one holding period for new “stock”
- Orezone Resources, Inc.
 - Merged into IAMGOLD Corp and distributed shares of Orezone Gold Corp.
 - Orezone was likely a PFIC
 - Merger is taxable. Gain may be allocable ratably over holding period and at highest tax rate and subject to interest for prior years
 - Not clear if Orezone Gold Corp. is also a PFIC

Other Challenging U.S. Corporate Actions

- Wyeth merger into Pfizer, Inc.
 - Wyeth survives as subsidiary of Pfizer
 - Merger did not qualify as a reorganization
 - Former Wyeth shareholders have not exchanged, for voting stock of Pfizer, an amount of Wyeth stock that constitutes 80% control of Wyeth
 - Receipt of both stock and cash is taxable
 - Company reports \$17.66 FMV per share Pfizer common

- Tim Hortons, Inc.
 - Merged into a newly formed Canadian subsidiary to move from Delaware
 - Exchange of Delaware Tim for Canada Tim
 - No loss can be recognized; gain recognized equal to excess of FMV of Canadian common received over Delaware common surrendered
 - Holding period carries over
 - Side effect - wash sale involvement
 - Holder recognizing gain in merger prevented from claiming loss on sale of Delaware Tim Hortons or Canadian Time Hortons for 30 day period before and after merger
 - Loss added to basis of newly purchased property, with adjustments

Key Issues in 2009

- Cross-border transactions
 - Need to understand details of local transaction (Banco Santander)
 - Need more transparency in depositary mechanisms, e.g. currency conversion
- Increased number of rights offerings in 2009 to raise capital
 - If value of rights 15% or more, basis adjustment may be mandatory (Rio Tinto)
 - If proceeds distributed (to ADR holders) remember to adjust basis
- Taxable common stock uncommonly commonplace recently
- Recurring issues
 - Return of capital
 - Partnership taxation
 - PFIC

Q&A

Please feel free to submit your questions by typing within the LiveMeeting “Questions and Answers” textbox.

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