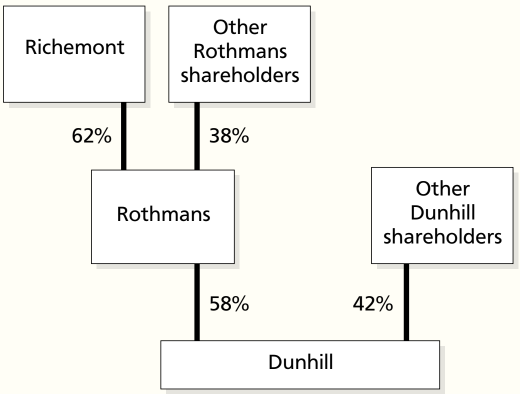
Rothmans restructuring

The tax advantages of twinned shares

In June, Rothmans, Richemont and Dunhill announced a proposed restructuring of the three companies' tobacco and luxury goods businesses into two new listed groups - New Rothmans (tobacco) and Vendôme (luxury goods).

The cornerstone of the restructuring is two schemes of arrangement (of Rothmans International and Dunhill Holdings). If approved, shareholders will receive entirely distinct "units" in each of New Rothmans and Vendôme. Both groups will have a dual holding company structure. Vendôme units will comprise twin shares in a UK holding company, Vendôme PLC, and in a Luxembourg holding company, Vendôme SA. New Rothmans units will comprise twin shares in a UK holding company, New Rothmans PLC and in a Netherlands holding company, New Rothmans NV. Broadly, it is intended that the British companies will own the UK

Before the restructuring



Before the restructuring each of Rothmans and Dunhill hold a mixture of tobacco and luxury goods assets.

businesses and the overseas companies, the non-UK businesses.

Twin share or similar structures have become increasingly popular amongst multinational companies as a way of reducing the adverse tax consequences of paying cross-border dividends.

Many jurisdictions impose a dividend withholding tax on dividends declared and paid between companies and their foreign shareholders. This invariably results in a resident receiving more favourable tax treatment than a non-resident shareholder. A double tax treaty may reduce this disadvantage but will not necessarily remove it altogether.

This problem has been reduced for groups of companies within the EC by a directive that provides, broadly, that there should be no withholding tax on a dividend paid by a subsidiary in one Member State to a parent company in a different Member State and that dividends received should be either exempted from tax or subjected to tax but with credit for underlying tax out of which the dividend is paid (*Council Directive 90/435/EEC, PLC, 1992, III(7), 31*).

Although dividends received from other EC countries may not suffer any significant UK tax costs, advance corporate tax (ACT) paid on dividends distributed to shareholders remains an effective tax cost to UK companies on dividends received.

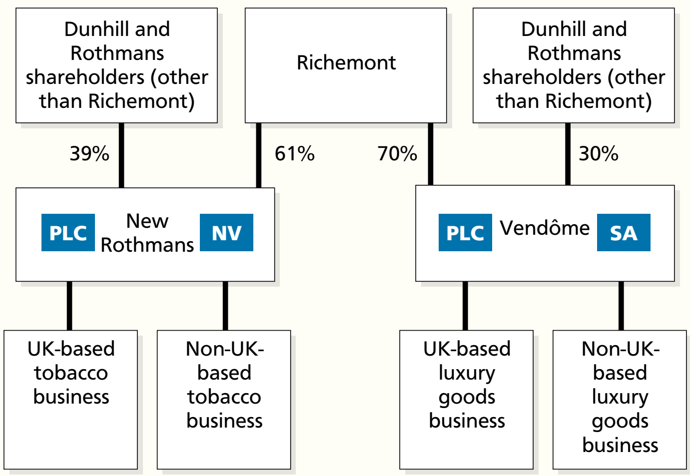
ACT is an advance payment of the company's UK corporation tax liability. Where the company is a holding company for companies abroad it may not have earned sufficient UK profits to offset the ACT; its profits will have been earned abroad, and ACT cannot be set off against overseas tax on those earnings. The ACT thus becomes an actual tax charge rather than an advance payment.

Enhanced scrip dividends have helped to relieve the surplus ACT problem (*see PLC, 1993, IV(5), 21*). The government has also announced proposals to relieve surplus ACT on foreign income dividends. But until this legislation is enacted, surplus ACT remains a significant problem for UK companies with substantial overseas operations.

Units comprising twin shares in a UK and foreign holding company help to avoid this problem because dividends can be declared and paid directly to overseas shareholders by the foreign company without being channelled through the UK.

The underlying principle of the Rothmans and Vendôme units is that holders should be put in the same position for all practical purposes as if they held shares in a single company, but with the ability to receive dividends from either holding company. A number of provisions have been inserted in the constitutional documents of the companies to achieve this aim. These include:

After the restructuring



After the restructuring the tobacco and luxury goods businesses will be divided between two groups - New Rothmans (tobacco) and Vendôme (luxury goods). New Rothmans and Vendôme will each have a dual holding company structure in which shareholders will hold units comprising twinned shares in a UK company (New Rothmans plc or Vendôme plc) and a Dutch company (New Rothmans NV) or a Luxembourg company (Vendôme SA). It is intended that the UK companies will own the UK based businesses and the overseas companies will own the non-UK based businesses.

Alternative structures

The twin share structure used in the Rothmans restructuring is an example of one of a number of methods that can be used to reduce adverse tax treatment of international groups.

At the time of the SmithKline Beecham merger, US shareholders received special shares in the US subsidiary stapled to ordinary shares in the UK parent. US resident shareholders received dividends direct from the US subsidiary. This means that US profits do not have to flow through the UK parent (and through the UK tax jurisdiction), thus avoiding the tax disadvantages this causes for both the shareholders and the group.

The merger between Wiggins Teape Appleton (WTA) and Arjomari in December 1990 resulted in a variation of the stapled share structure. The merger was structured so that dividends from Arjomari Europe (the principal French operating subsidiary) could be paid to a French holding company and on to French shareholders without having to be paid through WTA and suffering UK tax (*see PLC, 1991, II(4), 3*).

When Reed and Elsevier merged in January 1993, each retained their separate corporate existences. Shares in the two companies are traded separately: there is no packaging or stapling. In the merged group, the underlying businesses have been combined under two companies in which each company has half of the voting rights. Equalisation arrangements have been adopted to ensure that dividends paid by the two companies are in a ratio that is, broadly speaking, constant. The same ratio is also applied to capital. The risk of the two parent companies adopting different distribution policies and hence the relative market values of the two companies fluctuating has therefore been minimised (*See PLC, 1993, IV (1), 15*).

● **Issue and trading.** Shares in the relevant holding companies will only be issued in the form of units. If either holding company within a twinned pair issues shares for cash, securities or other consideration (for example, if it buys assets in exchange for shares), it will pay cash to the other holding company equal to the nominal value of its shares issued as part of the units to the extent that the nominal value is not paid by a third party or by capitalisation of reserves.

Holders of units will only be able to trade them in unit form and the shares comprising the units will not be capable of being traded separately.

● **Dividends.** Holders of units will be able to elect to receive dividends from either the UK holding company or the relevant overseas holding company.

Dividends will be equalised at the gross level so that the dividend paid by the relevant overseas company will equal the net dividend paid by the UK companies together with the associated UK tax credits.

The directors of each holding company retain a discretion not to apply the equalisation principle. One circumstance in which this discretion may be exercised is disclosed in the listing particulars of New Rothmans. Unless the necessary tax confirmations are given by the Inland Revenue, the great majority of the Dutch holding company's assets will be held through a wholly owned UK holding company. In the circumstances, the Dutch company board may consider exercising its discretion to reduce the amount paid by the Dutch holding company and so encourage shareholders to elect to receive dividends from the ultimate UK holding company.

Presumably the directors may also use their discretion not to apply the equalisation principle if one company within a twinned pair has substantially greater distributable profits than the other.

● **Management.** The boards of each company within a twinned pair will be identical.

● **Alterations to share capital.** Resolutions which may alter the share capital of either company within a twinned pair or otherwise have an effect on the twinned share principle must be conditional upon a resolution of substantially similar effect being passed by shareholders of the twin company.

If (and when) the foreign income dividend legislation comes into force in the UK, the tax reasons for twinned share structures may become less compelling. But they are likely to remain popular where a multinational has a significant number of overseas shareholders and operations in countries that impose withholding tax on dividends and a double tax treaty does not reduce the problem. ***CJM***