

A Biweekly
Newsletter of
Federal Securities,
Corporate &
Banking Law
Developments

SEC Approves New NYSE and Nasdaq Corporate Governance Standards

After several months, the Securities and Exchange Commission finally approved on November 4th the new NYSE and Nasdaq corporate governance listing standards. (<http://www.sec.gov/rules/sro/34-48735.htm>) The rules present new requirements and standards for determining board member independence, establishing various board committees, adopting codes of conduct for directors, officers, and employees, disclosure mandates, and other related matters.

Even though the NYSE and Nasdaq rules are similar in subject matter, there are differences between the two. Some of these distinctions are as follows:

- Under the Nasdaq rules, directors are not considered independent if they receive more than \$60,000 in payments from the listed company, whereas the NYSE compensation threshold is \$100,000;
- Unlike the NYSE rules, Nasdaq does not require listed companies to have compensation and nominating committees;
- Unlike the Nasdaq rules which require audit committee members to understand financial statements as of the date of their appointment, the NYSE will allow an audit committee member to become "financially literate" within a reasonable amount of time.
- Pursuant to the NYSE standards, all members of the audit committee must be independent. Nasdaq permits an audit committee to have one non-independent director for a limited time if certain criteria are met.

These new NYSE and Nasdaq rules generally take effect by the earlier of a company's first annual meeting occurring after January 15, 2004 or October 31, 2004. **With the compliance deadline fast approaching, NYSE and Nasdaq**

listed companies should conduct a legal audit as soon as possible to ensure compliance with the applicable listing standard.

IN THIS ISSUE:

- SEC Approves New Governance Standards for NYSE and Nasdaq
- Reinvested Corporate Dividends Can Be Tax Deductible
- IRS No Longer Issuing Advice on Tax Consequences in Spin-Off Transactions

If you would like more information on these topics or have any questions, please e-mail us at CorporateNotes@KutakRock.com.

■ ESOPS: MAKING CORPORATE DIVIDENDS TAX DEDUCTIBLE

John E. Schembari, a corporate partner from our Omaha office, writes:

If your C corporation (i) currently pays dividends and (ii) also sponsors a 401(k) plan or Employee Stock Ownership Plan ("ESOP") that invests in the stock of the employer, the IRS code now provides for a significant tax deduction associated with the distribution and reinvestment of those dividends.

To take advantage of this tax deduction, your C corporation must either establish or have an existing ESOP, or alternatively convert the employer stock portion of its 401(k) plan into a KSOP (a combination ESOP and 401(k) plan). Once established, the C corporation can claim a federal income tax deduction for dividends paid in cash directly or indirectly to an ESOP participant, dividends used to make an ESOP loan payment, or dividends that an ESOP participant elects to have directly reinvested in company stock held by the ESOP. This deduction for reinvested dividends is new.

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FAYETTEVILLE
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LINCOLN
LITTLE ROCK
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OMAHA
PASADENA
RICHMOND
SCOTTSDALE
WASHINGTON
WICHITA

The reinvestment tax deduction is available as long as it meets certain conditions, such as:

- An ESOP participant must have the choice of reinvesting the dividend or receiving it in cash;
- An ESOP participant must be able to change the dividend reinvestment election annually; and
- ESOP participants must be fully vested in the dividends being reinvested.

This tax deduction makes ESOPs more attractive than ever to corporations that pay dividends and have company stock in a qualified retirement plan. In light of this tax deduction opportunity, you may wish to amend your existing 401(k) plan to incorporate an ESOP feature.

■ TAX RISK INCREASES IN CORPORATE TRANSACTIONS

The IRS recently announced that it will no longer issue advice, also known as private letter rulings, regarding the tax-free treatment of spin-off transactions. Spin-offs are transactions in which a company's division, or one of its subsidiaries, becomes a separate entity owned by the stockholders of the original company.

This continues an IRS trend of limiting its advance guidance on the tax-free nature of certain corporate transactions. In 1990, the IRS announced it would no longer issue private letter rulings on whether certain types of mergers were tax-free.

To mitigate the business risk of entering into a merger or spinning off a company without obtaining a favorable IRS ruling in advance, a company usually has three options:

- Rely upon common types of transactions with long-accepted tax-free consequences (however, such standard transactions may not meet the business goals of a particular transaction, or may not contemplate an unusual fact or situation in your "real world" deal);

- Rely upon the opinion of a tax advisor who is experienced in the transaction (however, tax opinions usually contain numerous qualifiers, and recent events have shown that the IRS is not hesitant to challenge them); or
- Avoid any tax-free types of transactions in favor of cash deals with taxable consequences.

Another alternative might be tax insurance, which covers the expected tax-free consequences of a corporate deal such as a merger. If the transaction is later determined to be taxable, then the insurance presumably would cover the tax losses to the stockholders. However, companies should expect that premiums for this type of insurance will be significant and therefore not practical in most transactions.

As the IRS continues to limit its role in tax guidance on mergers and other corporate transactions, companies should consider the alternatives available to mitigate their tax risk.

Kutak Rock LLP is a national law firm with more than 325 attorneys located in 16 offices throughout the United States practicing in the areas of corporate, banking and securities law, mergers and acquisitions and stock offerings, federal government contracts, and complex commercial litigation matters.

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