The Hows and Whys of Corporate spin-offs in Qatar

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For companies to reduce risk, improve financial performance and become more effective and efficient, they often require new strategic alternatives. More and more companies are using “spin-off” operations to boost their economic activity.

What is a “spin-off”?

A spin-off is the creation of an independent company through the roll-over of an existing business/division of a company to a new legal entity. A spin-off operation is where a company, which engages in various activities, creates a new company which specialises in one specific area of business. The company spins-off the business to a newly created company in which the shareholders are identical to the shareholders of the original company spinning-off that business. Following the transaction, both the original company and the new spun-off company are completely separate and independent legal entities. The newly-created entity will be specialised in one activity. Consequently, following the spin-off exercise there would be different specialised activities within one group of entities.

Reasons for a Spin-Off

Spin-off transactions have the ability to create new opportunities for companies.

Some reasons why a company would engage in a spin-off include:

- Focus on its core business and present a clearer financial picture of the separate entity;
- Have a better targeting of investors;
- Develop and realise full shareholder value;
- Refocus one activity which creates a positive effect on the valuation of shares;
- Give a better allocation of internal capital within the conglomerate;
- Assist in improving the performance of management;
- Be more responsive to the market’s evolution;
- Assisting in tax planning;
- Creating a positive effect on the valuation of a conglomerate and therefore on the value of the securities held by the company’s shareholders ; and (perhaps most importantly)
- Provide asset protection concerning the debts of one particular business activity. For the original company, perhaps the principal benefit of spinning off a troubled or risk-ridden operation is that the market value of the presumably profitable remaining businesses may be enhanced by the elimination of risk-ridden or under-performing assets.

These reasons explain and justify the rationale for companies using this alternative option as a key solution to improving their financial performance and efficiency. However, in sophisticated tax jurisdictions, care needs to be taken that the disposal of a part of the business does not trigger tax consequences such as a capital gains tax disposal. In fact tax consequences such as triggering capital gains tax events, or loss of an ability to utilise losses is perhaps the biggest down-side of a spin-off.

Case Studies

Corporate spin-off is not a recent phenomenon. Since the wave of consolidation in the United States and Europe in the 1980s, some academic research has concluded that when a business conglomerate has various economic activities, its value decreases. A company's value is negatively influenced by the diversification of its activities when it has at least two distinct business sectors.

Since 2005, there have been significant spin-off transactions:

• In 2006, creation of Arkema, separated from Total.

• In 2008, creation of Axway, separated from Sopra Group.

• In 2011, creation of TripAdvisor, separated from Expedia.

• In 2011, creation of Aperam, separated from ArcelorMittal.

• In 2013, creation of Osram, separated from Siemens AG.

Even Expedia's board has approved a plan that would break the company into two public companies. One would be a travel agency, focused on selling air, hotel and car rentals and the other one would be TripAdvisor, the travel reviews site that operates in 27 countries and 19 languages.

Qatar

Chapter 9, Section 3 of the Qatari Commercial Companies Law (Law No. 5 of 2002) allows for corporate spin-offs.

According to the Qatari provisions, a company may be divided into two or more companies with either termination or preservation of the company subject to division. Moreover, the companies arising from the spin-off have an independent legal personality with all its respective effects (Article 278).

The new company which is spun-off is able to take any of form permitted by law (Article 279).

Companies resulting from the spin-off shall be successors to the initial company, and shall be its legal substitute within the limits of what has been transferred to it from the initial company (Article 280).

How Corporate Spin-Offs May Be Useful In Qatar

Corporate spin-offs may help attract investment in Qatar. Since the new entity is specialised in one specific sector, the new investor can have a better picture of its economic health.

In addition, a spin-off transaction creates a separation of the different companies' legal status and results in one entity becoming immune from problems of the other. Therefore, a company would not be liable for the debts of another company within the same group. This can also work for carving out toxic assets. However, factors such as timing and economic specificity of the country are critical to successful spin-off planning.

Given the structure of many Qatari companies, especially family businesses that have traditionally developed into multiple-sector operations, a corporate spin-off may prove to be an attractive option to increase financial performance and diversify their activities and concentrate their efforts on one sector; and the market may react positively to announcements of spin-offs. Furthermore for family business in estate planning and succession it may be an effect mechanism to divide assets amongst family members simply and can be used inter vivos as well.

For 100% Qatari-controlled businesses, there are no tax consequences in undertaking a spin-off, but for companies that have foreign shareholding, tax does become a consideration that needs to be taken into account.