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SPAC TRANSACTIONS: TRENDS AND KEY TAX ISSUES

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INTRODUCTION AND TRENDS

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- **Special Purpose Acquisition Company (“SPAC“)** or “blank-check“ company
- SPACs **raise capital** through an **IPO** to **acquire** one or more **operating businesses** through a business combination
  - Typically listed on NASDAQ or NYSE
- Generally formed by **experienced management team** – “Sponsors“
  - Sponsors leverage their relationships, reputation and experience to attract investors
- Lifespan of the SPAC is generally **18-24 months**

INTRODUCTION AND TRENDS

Year	SPAC IPOs	IPO Proceeds $M	Avg IPO Size $M
2021 (YTD)	308	$100,310	$326
2020	248	$83,347	$336
2019	59	$13,600	$231
2018	46	$10,752	$234
2017	34	$10,049	$296
2016	13	$3,499	$269
2015	20	$3,903	$195

Source: SPAC Insider (26/04/2021)

	Number	Proceeds $M
SPACs seeking acquisition	427	$138,650
SPAC IPO pipeline	254	$63,588

Source: SPAC Analytics (26/04/2021)

OVERVIEW OF A SPAC TRANSACTION

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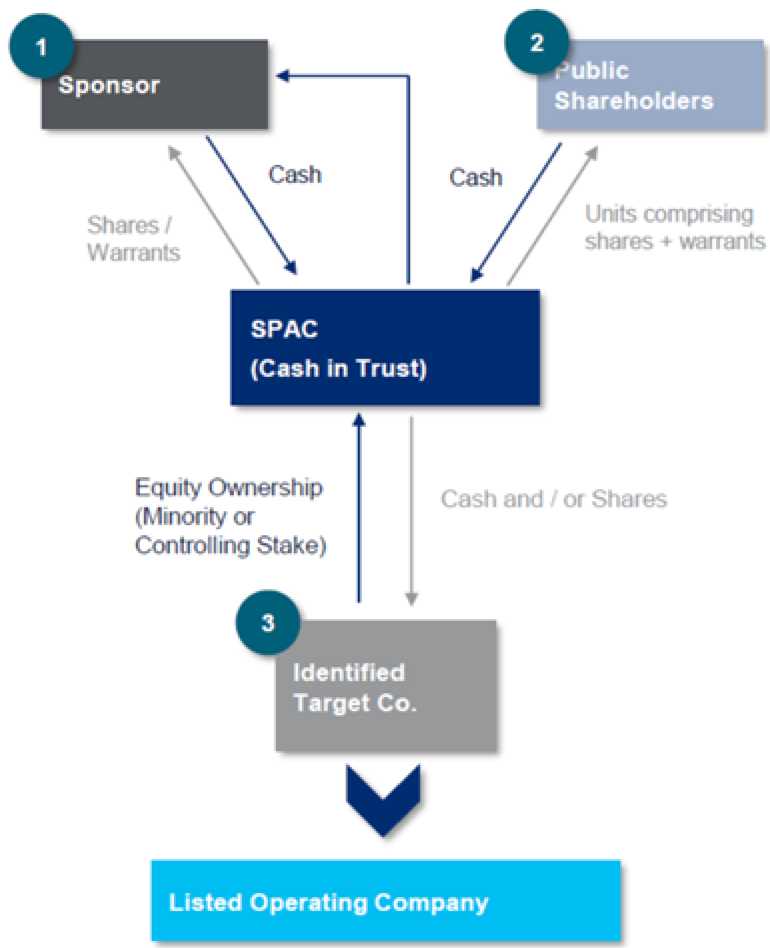

OVERVIEW OF A SPAC TRANSACTION

SPAC Lifecycle Can Be Broken Down Into 3 Distinct Phases

1 SPAC IPO

- 3 months long process from kick-off to listing

2 Listing to Business Combination Announcement

- SPAC has 24 months from its listing to identify a target and announce business combination

3 Announcement to Closing

- Typically 90 day / 3 month process from business combination announcement to closing of the merger

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WHAT NEEDS TO BE CONSIDERED…

… WHEN ESTABLISHING THE SPAC

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - US

- Choosing the SPAC’s country of domicile is a key early decision

- The expected location of the SPAC’s target is an important factor in this decision
  - Generally use a domestic (US) SPAC if targets are expected to be US entities
  - Generally use a foreign (non-US) SPAC if targets are expected to be foreign entities

- Often easier to start by using a foreign (non-US) entity for the SPAC and then bring it onshore if the SPAC identifies a US target. It is harder to start with a domestic (US) SPAC and move the entity offshore if a foreign target is later identified.

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - US

- ***Benefits*** of a ***domestic (US) SPAC*** if a ***domestic (US) target*** is expected:
  - Generally domestic SPACs can acquire domestic targets in a tax-efficient manner; there is a clear application of US corporate reorganization rules in this situation
  - Allows for tax-deferred exercise of IPO warrants
  - US corporations can file consolidated returns

- ***Challenges*** of a ***domestic (US) SPAC*** if a ***foreign target*** is expected:
  - Foreign law may not provide tax efficient acquisition structures for a US SPAC
  - Income from a foreign target may be subjected to US income tax (for example, the target may become a CFC of the SPAC)
  - US SPAC may have to pay US withholding taxes on distributions paid to foreign shareholders.
  - US tax anti-inversion rules can make it hard to move a US SPAC offshore to avoid these inefficiencies if it later identifies a foreign target

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - US

- ***Benefits*** of a ***foreign (non-US) SPAC*** if ***foreign (non-US) target*** is expected:
  - Generally foreign entity can move from the foreign jurisdiction in which it was created into the correct foreign jurisdiction to allow for an efficient acquisition structure of the target under foreign law.
  - Does not subject *all* of the SPAC's income to US income tax
  - No US withholding taxes on SPAC distributions

- ***Challenges*** of a ***foreign (non-US) SPAC*** for a ***domestic (US) target*** is expected:
  - Usually, foreign SPAC moves into US if it identifies a US target.
    - In this situation, US Shareholders are typically subject to tax on SPAC's existing earnings & profits (often not very much because only income is interest).
    - There could be US tax anti-inversion concerns if a foreign SPAC were to acquire a US target without first moving the SPAC's domicile into the US.
  - Foreign SPAC may be a passive foreign investment company ("PFIC"), which can make domesticating the SPAC more difficult / expensive.
    - If foreign SPAC is a PFIC then domesticating SPAC is taxable unless SPACs shareholders make certain elections (e.g., qualifying electing fund "QEF" election)

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - US

- Foreign (non-US) SPAC is usually a PFIC under general US rules, unless an exception applies:
  - Foreign SPAC typically fails US PFIC rules because either 75% of its gross income is passive (e.g., interest) income or more then 50% of its assets are passive assets (cash holdings is treated as passive for this test).
  - Default tax consequences of PFIC status can be severe: US shareholders taxed at ordinary income rates on “excess distributions” (which includes stock sales) and an interest charge on deferred tax liability.
  - Once foreign corporation fails a PFIC test during US shareholder’s holding period, it remains a PFIC for that US shareholder. (“Once a PFIC, always a PFIC.”)

- Start-up exception applies for first tax year (exception applies if no predecessor entity and entity establishes that it will not be a PFIC for either of the next two years)
  - Benefit of start-up exception can be limited because SPACs typically have ***two*** years to complete a de-SPAC transaction

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - US

- US Shareholder can elect out the default PFIC regime using either a qualified electing fund ("QEF") election or a mark-to-market election.

- QEF Elections
  - US taxpayer making QEF election includes currently includes in taxable income its pro rata share of the PFIC's income
  - No interest charge on deferred tax liability if a valid QEF election is made
  - US shareholder can only make a QEF election if it receives the necessary income from the PFIC
  - QEF election is usually not that expensive since SPAC only has interest before the de-SPAC transaction
  - How QEF election applies to warrants issued in IPO is unclear
    - Under proposed regulations, QEF election is not available for options or warrants; could result in harsh tax consequences

- Mark-to-market election
  - US shareholder treated as if it sold PFIC stock at end of each year; any gain deemed to be recognized taxed at ordinary rates.
  - Only available if PFIC is traded on a qualified exchange

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC – GERMANY

- **German** domestic **SPACs** are pretty **unusual**
  - Germany is **high tax country**
  - Amendments in German tax law to be considered after the general election in autumn 2021 (**introduction of a wealth tax?**)
  - Corporate law restrictions for SPACs in the legal form of a German *Aktiengesellschaft* (free disposal of share capital by the management?; repayment of contributions before the expiry of the 12-month liquidation lock-up period?)

- Location of SPAC during **investment phase** should be less relevant (no/minor income expected); **on-shoring prior to De-SPAC transaction** to be considered

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TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC - IRELAND

- Currently **no Irish domiciled** SPACs

- A SPAC located in a **non-DTA jurisdiction** would give rise to **issues for Irish based investors**
  - Participation exemption unavailable on subsequent exit

- Irish **stamp duty relief** on de-SPAC transaction typically **only available where** the acquiring company is **incorporated in the EU**
  - **Migration to EU jurisdiction** in advance of De-SPAC transaction would be typical

TAX CONSIDERATIONS WHEN ESTABLISHING THE SPAC – SPAIN

- **Spain** domestic **SPACs** are also currently inexistent
  - No current regulation of this specific type of vehicle

WHAT NEEDS TO BE CONSIDERED …

… WHEN ESTABLISHING THE SPONSOR AND FOR THE MANAGEMENT TEAM

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM – GERMANY

- **SPACs are formed by sponsors** with specialized financial, operational or other capabilities – usually former industrial executives, institutional investors, private equity investors.

- SPACs sponsors are responsible for forming the SPAC, raising capital in the SPAC IPO, identifying target and consummating the acquisition.

- Sponsors are granted an initial separate class of shares for nominal consideration (“**founder shares**”) with **warrants** attached. After IPO the founder shares rank junior to the public shares and have no redemption rights prior to the De-SPAC or liquidation.

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TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM – GERMANY

- **Tax treatment of the "founder shares":** "Mere equity" or "disguised compensation"?

    - What is the **value of the "founder shares"** at the time of the acquisition (not at the time of the IPO/established market value)?
    - Generally no identified target at the time of acquisition and no approved IPO.
    - Only cash (minimal assets) and expectation.
    - No imputation of value to future services.

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM – GERMANY

Tax treatment of warrants

- Warrants are issued in connection with the stock; value of warrant is attributable to the value of stock; when exercising the warrants, investors pay strike price to the SPAC.
- Warrants become exercisable *e.g.* upon completion of the business combination and one year after IPO and entitle holder to acquire shares at (fixed) strike price.

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM – GERMANY

Tax consequences (Germany):

- Full availability of **participation exemption** for **capital gains on shares** (95% exemption; not applicable for credit/financial institutions and life/health insurance companies).
- **Warrants** are not taxed upon receipt (as long as priced at fmv) and not taxed upon exercise. **Full taxation** on capital gains on warrants.
- Shares and warrants with a **compensatory character** issued for services should be fully taxed when acquired (below fmv)/exercised.
- **German CFC** applicable for investment made in foreign company with lowly taxed (< 25%) passive income (Cayman SPAC) and German investor(s) hold > 50% in foreign company (> 1% passive investment income).
- **Withholding taxes on distribution** by sponsors: availability of DTT/EU-relief.

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM - US

- "Cheap Stock" issue
  - Sponsor typically receives founder shares for a relative small investment
  - The founder shares typically represent 20 percent ownership in the SPAC after the IPO (these shares function in a manner similar to the carried interest in private equity structures)

- Major US income tax issue for sponsors is whether receipt of founder shares represents compensation
  - Resolution of this issue can be the difference between ordinary income (subject to employment taxes) and capital gains for the sponsors.

- To mitigate the risk of compensation, founder shares are typically issued as close in time to SPAC formation as possible.
  - The closer in time to formation in which founder shares are issued, the more risks and contingencies exist between the issuance of the founder shares in the potential IPO or acquisition.

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM - SPAIN

- Income deriving from foreign SPACs could be subject to **Spanish CFC taxation** at level of the shareholders (sponsor, investors)
  - Passive low taxed (< 18.75%) income
  - Participation of Spanish shareholders (individually or together with related parties) = or > 50%
  - Relief for EU companies available if business rationale behind

- Both in connection with SPACs and Sponsors, critical point from a tax perspective is to determine its **tax residence** (special attention should be paid to the concept of "**place of effective management**" and the existence of potential "shared" human and/or material means)

TAX CONSEQUENCES FOR THE SPONSOR AND THE MANAGEMENT TEAM - IRELAND

- Founder shares- are they **disguised compensation** for services?

- **Valuation** of founder shares
  - **Timing of issuance** will be important- pre-IPO and prior to identifying a target
  - SPAC should have minimal assets

- Tax treatment of share warrants depends on type of warrant
  - **Compensatory warrants** issued for services would be considered **taxable income** subject to tax on exercise or disposal

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WHAT NEEDS TO BE CONSIDERED …

… AT THE IPO

TAX IMPLICATIONS OF THE IPO - SPAIN

- The IPO marks the **“entry” into scene of** the **public shareholders**
  - From a legal (listing) and commercial perspective it represents the date of birth of the SPAC
  - It also fixes the **initial price** that independent parties have “paid” (committed) for joining the project
  - As a general rule listing **costs** (banks, advisors, lawyers, etc.) are assumed by the SPAC but funded by the sponsor

- The IPO may imply, depending on its precise terms, the **conversion** of the founder shares (and the warrants) into ordinary shares at the level of the sponsor:
  - In principle, such a transfer would imply a **taxable event**
  - Requirements for the application of the Spanish **participation exemption** regime (95% exemption) to be carefully analyzed:

TAX IMPLICATIONS OF THE IPO - SPAIN

- 1 year maturity and minimum 5% over the "share capital"; and
- SPAC not to be resident in tax haven for Spanish purposes (Cayman Islands is); and
- SPAC not to be considered as an asset-holding company; debatable whether the SPAC activity (search for the target) meets the Spanish definition (no binding ruling has been issued so far in this regard)
  - Tax consequences to be analysed on a case-by-case basis

TAX IMPLICATIONS OF THE IPO - US

- SPACs issue “units” in an IPO that consists of a share of stock and a warrant for a partial share (typically 1/3 or 1/4 of a share).

- US holding period issues: Holding period of shares acquired for the exercise of the warrant do not include the period in which the investor held the warrant.

- Also note that potential PFIC consequences (previously discussed) to US holders of warrants in a foreign SPAC could be particularly harsh because QEF elections cannot be made for PFIC warrants.
  - Without a QEF election, a US holder of PFIC warrants might be treated as realizing ordinary income at the time a PFIC SPAC changes its domicile from a foreign jurisdiction to the US.

TAX IMPLICATIONS OF THE IPO - IRELAND

- **Conversion** of founder shares on IPO should not be a taxable event
- For the purposes of the capital gains tax **participation exemption**, **holding period** would only begin once warrants are exercised and shares acquired

TAX IMPLICATIONS OF THE IPO - GERMANY

- **Conversion** of founder shares into ordinary shares
  - In principle, the mere modification of the membership rights of a shareholder does not lead to a taxable event
  - Tax consequences to be analyzed on a case-by-case basis

WHAT NEEDS TO BE CONSIDERED…

… WITH REGARD TO THE DE-SPAC TRANSACTION

TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION - IRELAND

- Key tax considerations on a De-SPAC include ensuring
  - **business combination** can be done on a **tax neutral basis** for target shareholders (apart from cash consideration)
  - **Non-recognition treatment** for SPAC shareholders
  - Structure is **tax efficient** going forward

- Ireland is a favourable jurisdiction to locate HoldCo
  - Extensive treaty network – 74 treaties
  - Credit based system which provides effective 0% tax rate on foreign dividends
  - Broad withholding tax exemptions for dividends paid to EU/ DTA residents
  - Participation exemption from CGT on disposals of certain shares
  - No stamp duty on shares traded through DTC

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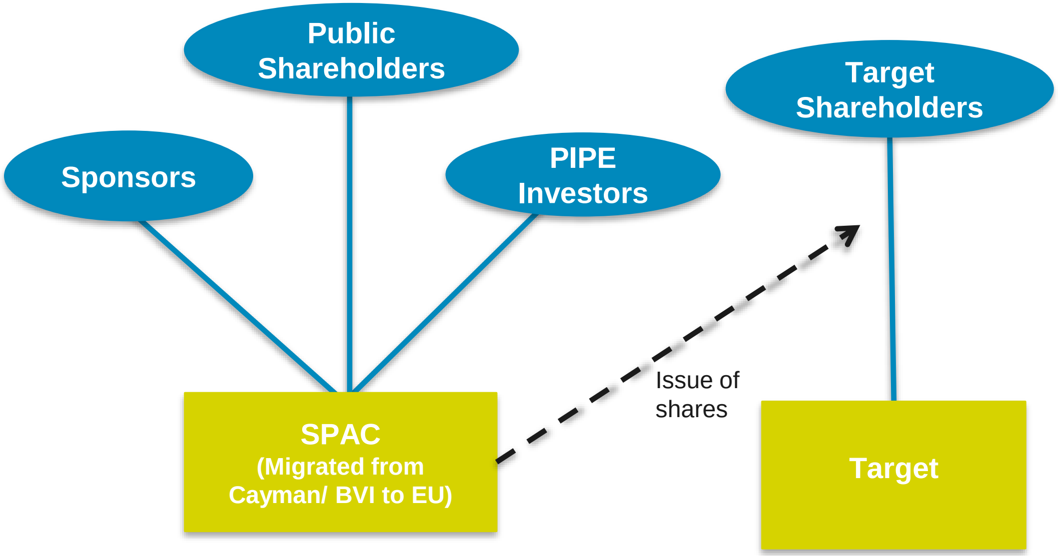
TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION - IRELAND

- Structure will typically depend on where the **target and major shareholders** are **resident** and the legal form of the target (corporation vs partnership)



- Cayman/ BVI incorporated SPAC **redomiciles to EU**
- SPAC acquires target in **exchange for issue of shares**
- Target shareholders should generally be entitled to **rollover relief** (subject to certain conditions). Irish shareholders who are entitled to **participation exemption** will be deemed to have made an exempt disposal of their shares (**new 12-month holding period** begins).
- **No stamp duty** for SPAC on acquisition of Irish Target **provided** acquiring company is in **EU**

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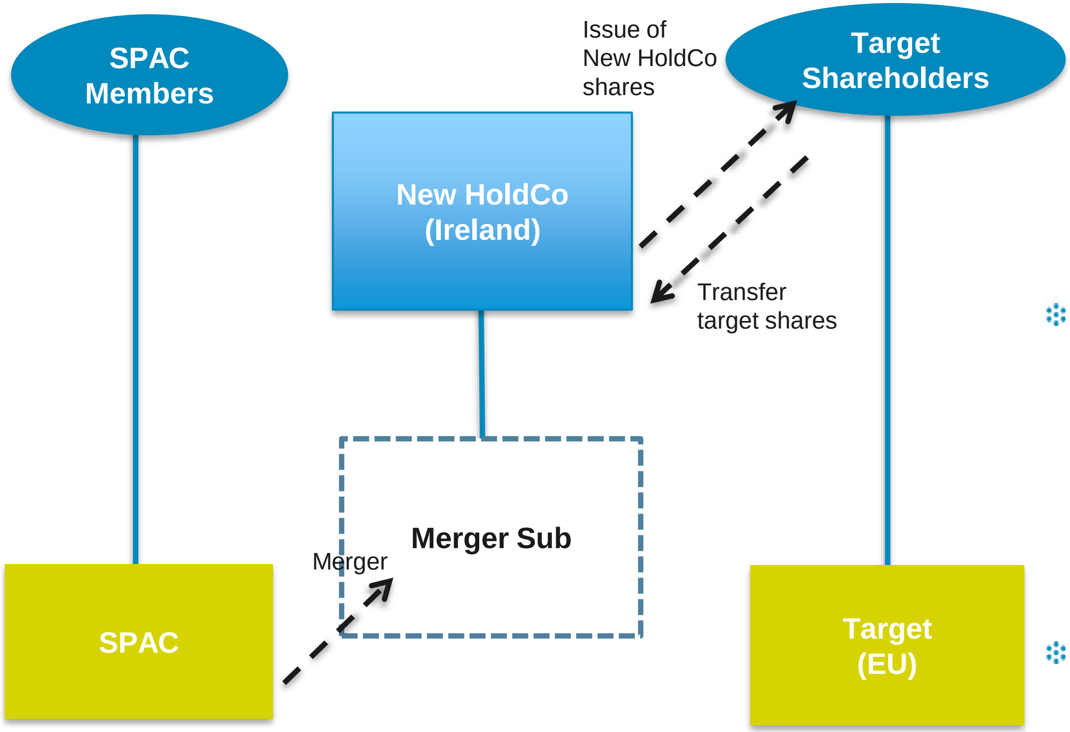
TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION - IRELAND



- New HoldCo forms Merger Sub
- New HoldCo acquires SPAC through **reverse triangular merger**, with SPAC surviving and becoming a wholly-owned subsidiary of New HoldCo. SPAC shares converted to New HoldCo shares. SPAC warrants adjusted to become New HoldCo warrants.
- **Share exchange** may be used in combination with reverse triangular merger depending on tax treatment of Target and location of major shareholders. In that case, Target will be acquired in exchange for issue of shares in New HoldCo.
- **Rollover relief** should be available for Target shareholders.
- **No stamp duty** on acquisition of Irish Target provided New HoldCo is in **EU.**

TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION - GERMANY

- A **tax-neutral share-for-share-exchange** is only available *i.a.* if the SPAC is EU/EEA resident and SPAC holds more than 50% in target

- Under current law a **tax-neutral merger** is only available for EU-/EEA companies
  - Requirement: **No restriction of German right to tax** the capital gains
  - ***Draft bill:*** *introduction of a possibility for tax-neutral mergers also for* ***third-country companies***

- On-shoring of the SPAC company prior to the De-SPAC transaction
  - **Legal entity** of the SPAC is **preserved**:
    - In general, no German tax consequences
  - **Legal entity** of the SPAC is **not preserved:**
    - (deemed) taxable liquidation of the SPAC resulting in a capital gain (if any)
  - Corporate law in the country of origin and the country of migration decisive

TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION – SPAIN

- Under current law a **tax-neutral merger** (or reorganization in the sense of the EU Directive) is only available for EU-/EEA companies
  - As a general rule, no Stamp Duty applicable in Spain upon issuance of shares in Spanish companies

- On-shoring of the SPAC company prior to the De-SPAC transaction: same general approach as in Germany

TAX IMPLICATIONS OF THE DE-SPAC TRANSACTION - US

- IPO investors typically have the right to redeem some or all of their shares if they disagree with a SPAC's proposed De-SPAC transaction.
  - Tax treatment of this redemption depends on the stock's holding period and whether the redemption qualifies for sale or exchange treatment or as an ordinary distribution

- SPACs often use a private investment in public equity ("PIPE") to provide additional equity to fund their investment in a target.

- SPAC transactions in the US typically rely on US tax-deferred corporation reorganization structures.
  - As with any tax-deferred corporate structure, typically, the receipt of cash by target shareholders (also known as boot) is currently taxable
  - SPACs can use an UP-C structure to accommodate acquisitions of partnership targets.
    - Depending on the nature of the structure, the De-SPAC transaction can include a tax receivable agreement, which allows a target's owners to capture a portion of the tax savings from certain attributes such as increases in the tax basis of assets.

- De-SPAC transactions differ from a typical IPO for the target because it allows a target to lock-in the pricing and structure terms of its IPO through up front negotiations with the SPAC.

QUESTIONS & ANSWERS

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