



SPECIAL PURPOSE ACQUISITION COMPANY ("SPAC") TAX ASPECTS AND CONSIDERATIONS

The formation of a SPAC presents some challenges when it comes to tax compliance. Given the larger issues of finding deal opportunities and SEC compliance, combined with limited staff, often leaves the more mundane corporate tax compliance issues overlooked.

Below you will find a discussion of certain aspects of the tax compliance issues that you may confront. This is by no means comprehensive and is not intended to be a substitute for a discussion with your tax team.

The Public Shell versus the Sponsor Entity Your Withum Team will be responsible for the preparation of tax compliance related to the Public Shell. Due to SEC independence rules we cannot provide tax compliance services for the Sponsor entity. We would be happy to provide you with a referral to a knowledgeable professional who can assist in the compliance. The remainder of this memo will address tax compliance issues just related to the Public Shell.

Basic US Filing Requirements All corporate entities are required to file a US federal corporate income tax return (Form 1120) on an annual basis regardless of activity. Corporate entities can choose either a calendar year end or a fiscal year end, however, its initial period can be no longer than 12 months. A year end is selected with the initial filed return.

The entity will also need a Federal ID number which should be obtained as part of the initial formation process. During the application for the ID number you will be asked about the intended tax year end.

The initial filing deadline for calendar year returns is the 15th day of the 4th month after year end. Corporations with a fiscal year end of June 30 are due by the 15th day of the 3rd month after year end (i.e., September 15th). An extension can be obtained that will provide 6 additional months to file the return. Note that the extension is only to file the form; any tax due must be paid with the extension.



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Entity Name We have experienced issues with entities who file for their federal ID number using one name, then change their name prior to the public offering. The IRS needs to be apprised of any name and or address changes to avoid issues with electronic filing and communication with the agencies. Notification can be made with form 8822-B for address changes. Name changes can be done with the filing of a return or by writing to the IRS at Stop 343, Cincinnati, OH 45999, or the address where the most recent return was filed.

BOOK VERSUS TAXABLE INCOME

Your Withum Audit team will work with you to audit and report on your financial data. Tax reporting will start with this information and will make certain adjustments based on differences in tax rules versus financial reporting rules.

Startup Costs The most substantive adjustment will be to capitalize essentially all of the costs, which would have been otherwise deductible, incurred by the entity during the year. The concept in play is that the SPAC is not yet “in business”, therefore the costs it is incurring are considered startup costs. These costs are capitalized until such time as the company is engaged in a business (does a deal) and can then be amortized over a 15 year period. See discussion below on this point.

Interest Income During the “startup” phase, the escrow account will generate interest income which is typically available to cover the costs of identifying a deal as well as general administration. Interest income derived will be recognized as taxable income. There will be no costs to offset the interest income (except for deductible state franchise taxes discussed below).

Franchise Taxes Many of the entities are formed in Delaware. Delaware has a franchise tax, (see discussion below) which will be currently deductible for tax purposes.



To recap, although the SPAC will have limited net income on an annual basis for financial reporting purpose, there will generally be a significant amount of taxable income.

Deferred Taxes The company will have to record deferred taxes on any book versus tax basis differences and tax attributes as part of its preparation for the financial statement audit. As discussed above, the components of deferred tax assets will primarily consist of temporary differences related to capitalized startup costs and net operating loss carryovers.

Tax Provisions The company will also need to consider the current income tax liability that will arise at the Federal level as a result of the receipt of taxable interest income in the escrow account.

Federal Corporate Tax Rates U.S. Federal Income tax rate is a flat 21% of taxable income.



DELAWARE FRANCHISE TAX

Entities formed in Delaware will need to file a franchise tax return with the State of Delaware. The return is due March 1 for the prior calendar year.

The State has a well-defined web site where the filing is done <https://corp.delaware.gov/paytaxes.shtml>. Often the entities agent in the State will file the return, however your Withum team is happy to assist with the calculation and set up of the process. We however cannot file the return on your behalf due to independence concerns. In very general terms the tax is payable annually for the previous calendar year up until the time dissolution has been affected with the state. The state has 2 methods for calculating the tax; the “Authorized Shares Method” or the “Assumed Par Value Capital Method”. The company is able to use whichever method generates the lowest tax amount. The minimum tax is \$175 and \$400 respectively with a maximum of \$200,000 or \$250,000 for large corporate filers (2018).

Most, if not all SPACs, will utilize the “Assumed Par Value Capital Method”. This method will require the accumulation of data regarding the value of assets reported on the federal tax return as well as the number of shares authorized at any point in the calendar year.

The State does have a template that can be used to calculate the tax <http://www.corp.delaware.gov/taxcalc.shtml>

ESTIMATED TAXES

Both the Federal government and the State of Delaware require estimated taxes to be paid. The following discussion addresses the general rules for estimates.

For specific requirements, see federal form 1120-W instructions at <https://www.irs.gov/pub/irs-pdf/i1120w.pdf>. The instructions for Delaware franchise tax estimates can be found at the link to the website above.

Federal Entities expecting their tax obligation to be in excess of \$500 are required to pay estimated taxes in 4 installments on the 15th day of the 4th, 6th, 9th and 12th month of its fiscal year.

All estimated tax must be paid electronically. See the section related to EFTPS below. Foreign corporations without a US bank account should be aware that they will need to make the payment via an intermediary or by check (see the instructions for IRS form 1120-W).

Delaware Entities with tax obligations greater than \$5,000 are required to make estimated tax payments as follows: 40% on June 1, 20% on September 1, 20% on December 1 and the remainder on March 1 when the return is filed. Note that Delaware is based on a calendar year. All estimated tax must be paid electronically using the States website.

EXPENDITURES OF THE SPAC

Most costs incurred by the SPAC, as mentioned above, will be capitalized for tax purposes. Ultimately when a deal is contemplated the nature of these costs will need to be parsed to identify the appropriate tax treatment. Below is a brief discussion of the complexion of the costs that are typically incurred. The specific tax treatment should be discussed with Tax counsel and Tax advisors upon the identification of a deal.



STARTUP COSTS

Startup costs relate to the expenditures associated with identifying an industry and business and effecting the opportunity.

STOCK ISSUANCE COSTS

Stock issuance costs, similar to financial reporting, are costs associated with the offering and solicitation of equity interests (e.g., filing, proxy, legal fees, etc.)

DEAL COSTS; THERE ARE SEVERAL VARIATIONS ON DEAL COSTS

Failed Deal Costs

As the name would indicate these are costs associated with opportunities that ultimately were not pursued.

Facilitative

Unless inherently facilitative, costs incurred in investigating or otherwise pursuing an acquisitive transaction are facilitative if incurred on or after the bright-line date. These costs are typically capitalized into the basis of acquired stock or assets acquired. "Bright-line date" means the earlier of the date a letter of intent, exclusivity agreement or similar written communication is executed by representatives of the acquirer and target or the date of authorization or approval by the corporation's board of directors .

Inherently Facilitative

Costs incurred for appraisals, negotiating the structure of the transaction, reviewing documents that effectuate the transaction (merger/purchase agreement), obtaining regulatory approval, obtaining shareholder approval, conveying property between the parties to the transaction are required to be capitalized into the basis of acquired stock or assets acquired. An acquisitive transaction includes: 1) [taxable acquisition of assets that constitute a trade or business](#), 2) [a taxable acquisition of stock, if immediately afterwards, the acquirer and target are considered related entities](#).

Non-Facilitative

Unless inherently facilitative, costs incurred in investigating or otherwise pursuing an acquisitive transaction are non-facilitative if performed before the bright-line date. Deductible as incurred, unless the company is in the "startup" phase as discussed above.

Success Based Fees

A success-based fee is a fee that is contingent upon a certain outcome of exploring and / or closing a transaction. Success-based fees are generally considered entirely facilitative, although a taxpayer could provide documentation to support whether a portion of these fees were non-facilitative. If the safe-harbor under Rev. Proc. 2011-29 is elected, 70% can be deducted currently as non-facilitative expenses (unless a company is in the "startup" phase, which could require capitalization as discussed above) and 30% is capitalized as facilitative expenses. Does not include debt-financing fees; can include milestone payments made after the transaction is closed.

STATE AND LOCAL TAXES

State and local taxes are currently deductible by the corporation.



Disposition of accumulated start up costs when a SPAC

Terminates In the unfortunate situation when a SPAC is unable to identify a deal and a decision is made to terminate the trust account, the unamortized start up costs will be deductible in the year of liquidation and dissolution.

USE OF NET OPERATING LOSS ("NOL") CARRYFORWARDS

A SPAC incurs NOLs as a result of the excess of currently deductible expenses (taxes) over taxable income earned (interest) on its trust account during its startup phase. Once the SPAC enters into a transaction and undergoes an ownership change, the future use of these NOLs may be limited.

In general, the rules of IRC section 382 apply to limit a corporation's ability to utilize existing NOL carryovers once the corporation experiences an "ownership change." Generally, an ownership change occurs when, within a span of 36 months (or, if shorter, the period beginning the day after the most recent ownership change), there is an increase in the stock ownership by one or more shareholders of more than 50 percentage points.

For example, if Shareholder A owned 25 percent of Corporation X, and within a space of three years, acquired another 51 percent, there would be an ownership change, triggering section 382.

In general, the rules of section 382 allow post-change corporations to use pre-change NOLs, but limit the amount that may be used annually to a percentage of the entity value of the corporation at the date of change of ownership.

That percentage is the highest "federal long-term tax-exempt rate," for the month during which the change in ownership occurs and the preceding two months; the federal long-term tax-exempt rate is determined monthly by the IRS along with other "applicable federal rates." Numerous special rules and limitations apply, including provisions dealing with "built-in gains and losses."

1099'S

The internal Revenue Service requires business entities to issue 1099's to any person or non-corporate entity to whom payments were made during the calendar year amounting to more than \$600. These documents are due to the recipient and the Internal Revenue Service on January 31 of the succeeding year. Generally the returns must be submitted electronically. Your Withum Team can assist in the preparation and filing of the returns.

We recommend that the entity provide IRS Form W-9 to all vendors <https://www.irs.gov/pub/irs-pdf/fw9.pdf> to obtain the relevant information. Note that some States may also require filing.

EFTPS

The Federal Government requires all payments of taxes to be made via their online payment system known as EFTPS. All entities should register for an account in advance of the need to utilize it as the typical turnaround time for the IRS is in excess of 2 weeks. The site to register the entity is <https://www.eftps.gov/eftps/>



STATE ISSUES

Doing Business

During the period of time that the SPAC is seeking a deal, or operating under an Administrative Services Agreement, the question as to whether the SPAC is doing business and or has created Nexus with a particular State or City is a highly fact sensitive issue to be addressed. Accordingly whether to register the entity with a particular jurisdiction should be evaluated on a case by case basis. Assuming that Nexus has not been created there is no state registration or related income tax filing requirement. As a word of caution the activities that the SPAC engages in including those of its personnel, officers and contractors acting on its behalf should be discussed with Tax and financial advisors to assess the point in time when Nexus has been created.

Address of the SPAC

One of the discussion points in evaluating the jurisdiction in which the SPAC will operate should include a discussion of the various methods the jurisdiction computes the entities tax base. Because the SPAC will have a large asset base as it seeks a deal, management should be sensitive to jurisdictions which have a tax on Capital. The result of the potential imposition of a capital based tax has caused us to recommend to our clients that they avoid any appearance of a connection to the taxing jurisdictions, including mailing addresses.

Nexus

The point at which a business entity is taking advantage of the opportunities in a jurisdiction, or has created nexus is a highly fact intensive decision. States have become significantly more aggressive in pursuit of tax dollars; accordingly it is critical that a discussion be had with your tax and financial advisors regarding the states where the entity is engaged in business and the point at which nexus is created.

Registration

The entity should not register to do business in a jurisdiction until such time as the discussion has been had regarding the tax compliance requirements.

TAX HAVEN ENTITIES

Some entities are formed in jurisdictions such as Cayman Islands. This presents some unique challenges to the entity and its shareholders. The US Federal government has numerous highly detailed reporting requirements related to interests in foreign entities owned by US persons. Accordingly robust disclosure to shareholders is critical.

Portfolio Interest Exception The discussion above regarding US income tax filing is very different for offshore entities. In fact there may be no US filing at all. Entities with just interest income from US Sources will generally qualify for the "portfolio interest exception" and there will be no requirement to file a US income tax return.

PFIC Issues A Passive Foreign Investment Company is defined in the Internal Revenue Code. In general terms it is a foreign entity whose assets are held for investment. The US holders of a PFIC have some specific filing requirements and elections that they need to make. The PFIC is disclosed and elections made on form 8621 by the US holder of the PFIC. The PFIC rules are highly complex and as a result the holder should seek tax counsel to understand its specific options.

PFIC Letters The entity may choose to issue PFIC letters to its holders on an annual basis (similar in concept to a K-1 from a partnership) which discloses to the holders their share of the entity's earnings which are in turn reported on their tax return and allows them to make certain elections. Your Withum tax team can assist in preparing these letters.



QEF election Qualified Electing Fund is one of the elections that can be made by the US holder. Under this election the holder reports the earnings of the PFIC on its return which preserves capital gain treatment on disposition of its shares.

Note that typically the first US holder is the Sponsor entity. In order for a QEF election to be effective it must be filed with a timely filed tax return of the US holder. Accordingly special attention should be paid to filing on time or obtaining a valid extension for the Sponsor.

PFIC Startup exception: Some SPAC entities formed offshore have taken advantage of the so called PFIC start up exception. The statutory language provides a very narrow exception to a shareholder falling subject to the PFIC rules. Specifically there is an exception for a start up company that engages in an active business operation, that has passive income, in its first taxable year. We encourage you to have a discussion with tax counsel and your compliance team to evaluate the availability of the exception and any planning that may be required.

Filing requirements — SPAC vs Shareholders SPAC Entities with no other US source income other than interest will likely not have a US filing requirement, however, in instances where there is “effectively connected income” or other US source income the entity will need to file a return with the Internal Revenue Service.



The holders themselves will need to assess their specific filing requirements based on their entity type and sources of income.

Backup withholding and information reporting Should an entity decide to pay a dividend to its holders, there are specific reporting requirements and potential withholding to be considered.

CFC Issues A foreign entity is a Controlled Foreign Corporation when it is held by a certain percentage of US holders. In this instance the CFC rules will override the PFIC rules and require the US holder to file form 5471 to disclose this relationship. Similar to the PFIC rules the CFC rules are highly complex and need to be assessed by each holder in conjunction with tax and financial counsel.

Transfers to Foreign corporations US holders may need to file form 926 to report certain transfers to foreign corporations.