

Financing Developments and Tax Considerations: IPOs, SPACs and UP-Cs

November 8, 2021

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Agenda

I. Market Landscape

1. Traditional IPOs vs. SPACs
2. SPACs and Reverse Mergers
3. UP-Cs and TRAs

II. Current Developments

1. Dual Class Stock
2. Significant Issues in de-SPAC Transactions



Market Landscape: Traditional IPOs vs. Special-Purpose Acquisition Companies

Traditional IPOs vs. Special-Purpose Acquisition Companies (SPACs)

Background

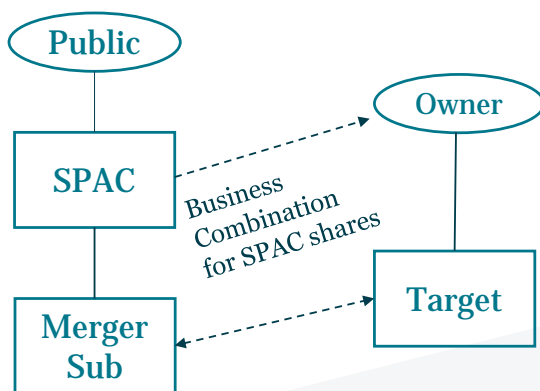
SPACs are acquisition vehicles that allow an investor to co-invest “publicly” side-by-side with the SPAC sponsor and provide the “de-SPAC target” an alternative to a traditional IPO.

- **Sponsor raises capital by selling units (i.e., stock and warrants) to public investors**
- **Sponsor receives a share “promote” and also buys warrants to cover the IPO placement costs**
- **The capital is held in trust, to be used in connection with a business combination**
- **The sponsor typically has two years to complete a business combination with a “de-SPAC target”**

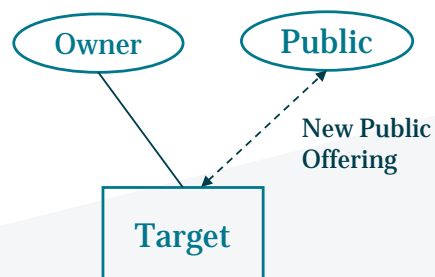
Traditional IPOs do not involve a “business combination,” but rather an initial offering of shares of a private corporation to the public in a new stock issuance. Companies must meet SEC and exchange requirements to hold an IPO, typically led by investment banks that market, gauge demand, set the IPO price, and the date of the offering.

SPACs vs. Traditional IPOs

de-SPAC Transaction:



IPO Transaction:



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Traditional IPO Compared to SPAC Merger

Traditional IPO

- Shorter marketing window
- Limited interactions with new investors
- Marketing based on historical financials
- Limited structural flexibility
- Underwriting fees, but no warrants or sponsor promote
- Execution uncertainty?

SPAC Merger

- **Longer marketing window, including access to “PIPE” (private investment in public equity) market**
- **Multiple interactions with investors**
- **Ability to disclose financial projections**
- **Ability to address complete capital structure, including committed debt**
- **Involves warrants and sponsor promote (subject to negotiation)**

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Traditional IPO Compared to SPAC Merger — Statistics

Year	SPAC IPOs	Total IPOs	SPAC %	SPAC Proceeds	US IPO Proceeds	SPAC %
2021	441	703	63%	126,841M	247,737M	51%
2020	248	450	55%	83,386M	179,389M	46%
2019	59	213	28%	13,600M	72,200M	19%
2018	46	225	20%	10,750M	63,890M	17%

Source: SPAC Analytics

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SPAC Merger — 2021 Statistics to Date

Statistics	#	Proceeds \$M
SPACs seeking acquisition	461	134,055
SPAC announced acquisitions	121	35,096
SPACs completed acquisition	414	99,507
SPACs liquidated	90	12,451
Total	1,086	281,109
SPAC IPO pipeline	284	65,726

Source: SPAC Analytics

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Market Landscape: Special-Purpose Acquisition Companies and Reverse Mergers

Reverse Merger vs. de-SPACs

Reverse Merger

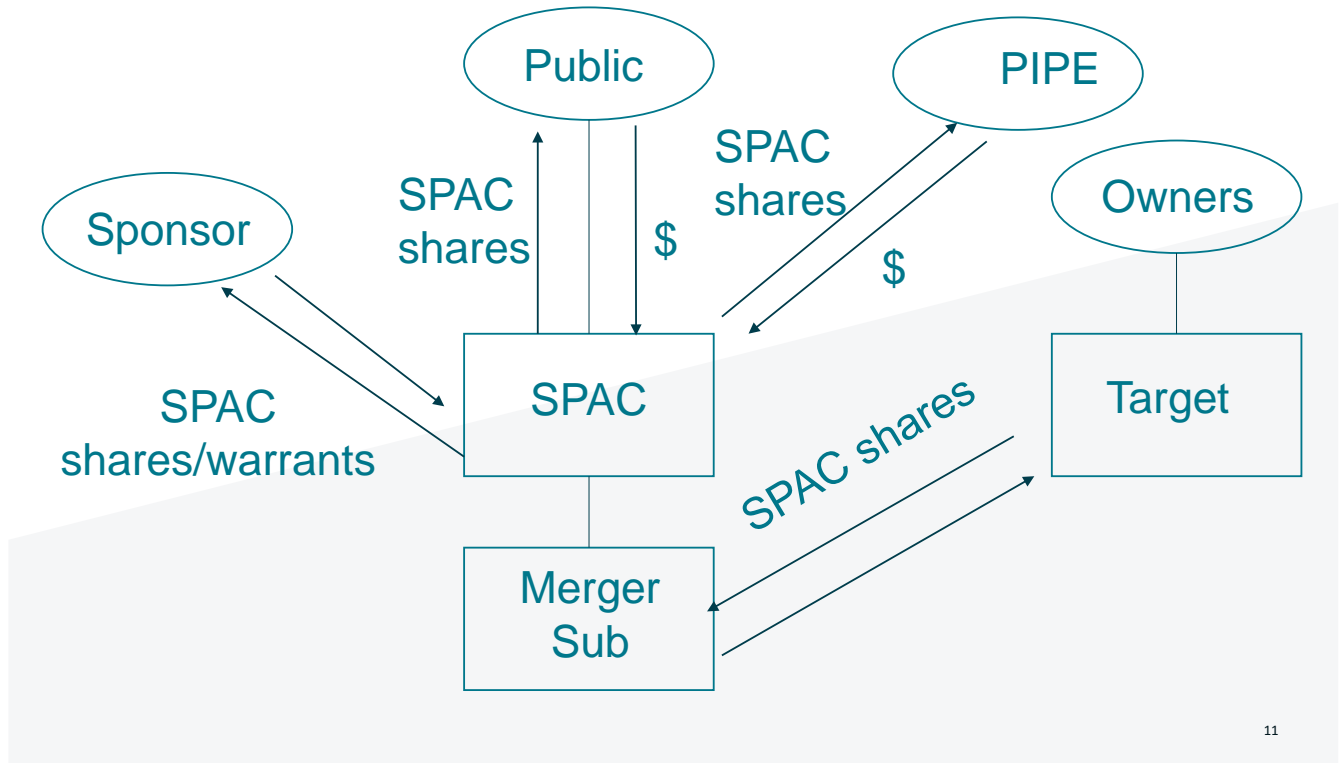
- Public company “acquires” private company, and former stockholders of private company acquire control of the public company
- No redemption rights
- Public company is often a dormant shell – thinly traded, no longer conducts business or holds assets
 - Common in biotech
- Private company typically takes over management and board of directors.

de-SPAC

- Same
- Redemption rights for investors
- Public company is newly formed and has no history of business operations
- SPAC sponsor actively participates in management and board of directors

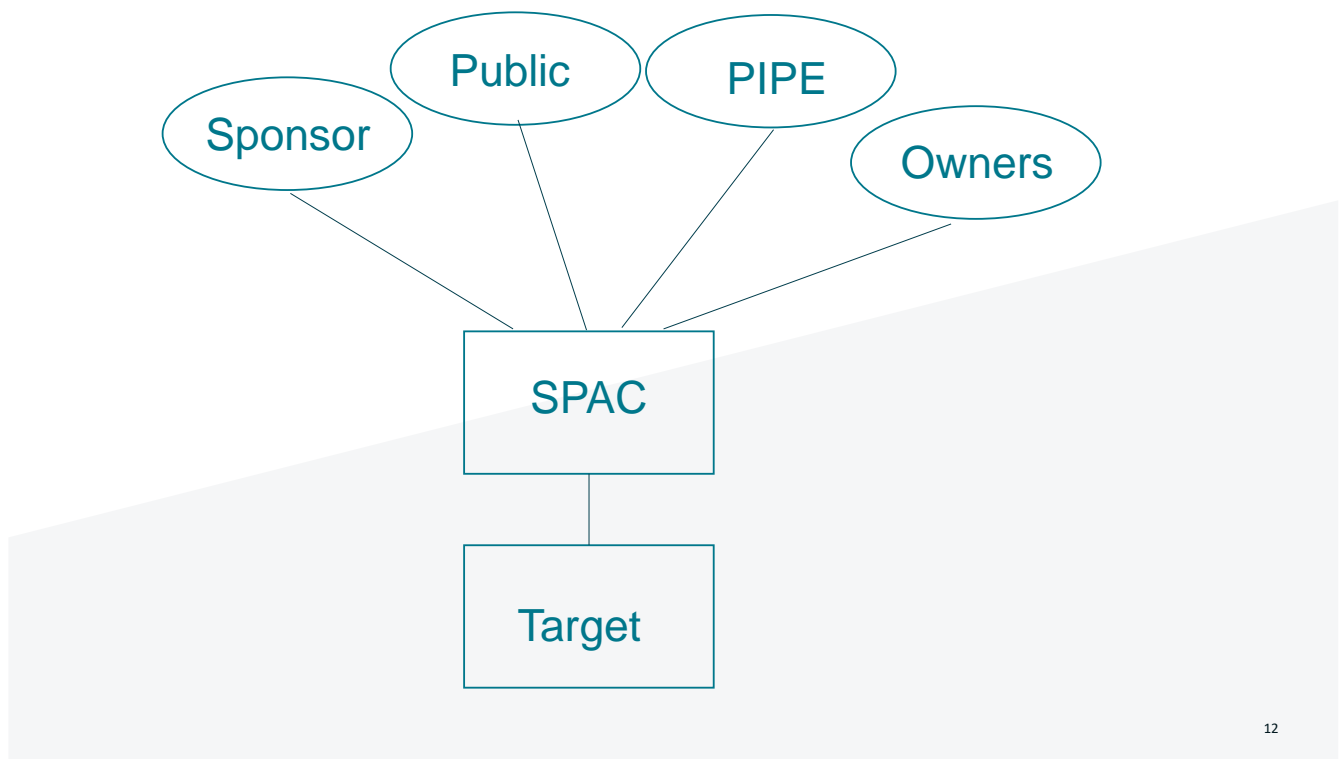
Basic de-SPAC Structures

Reverse Triangular Merger



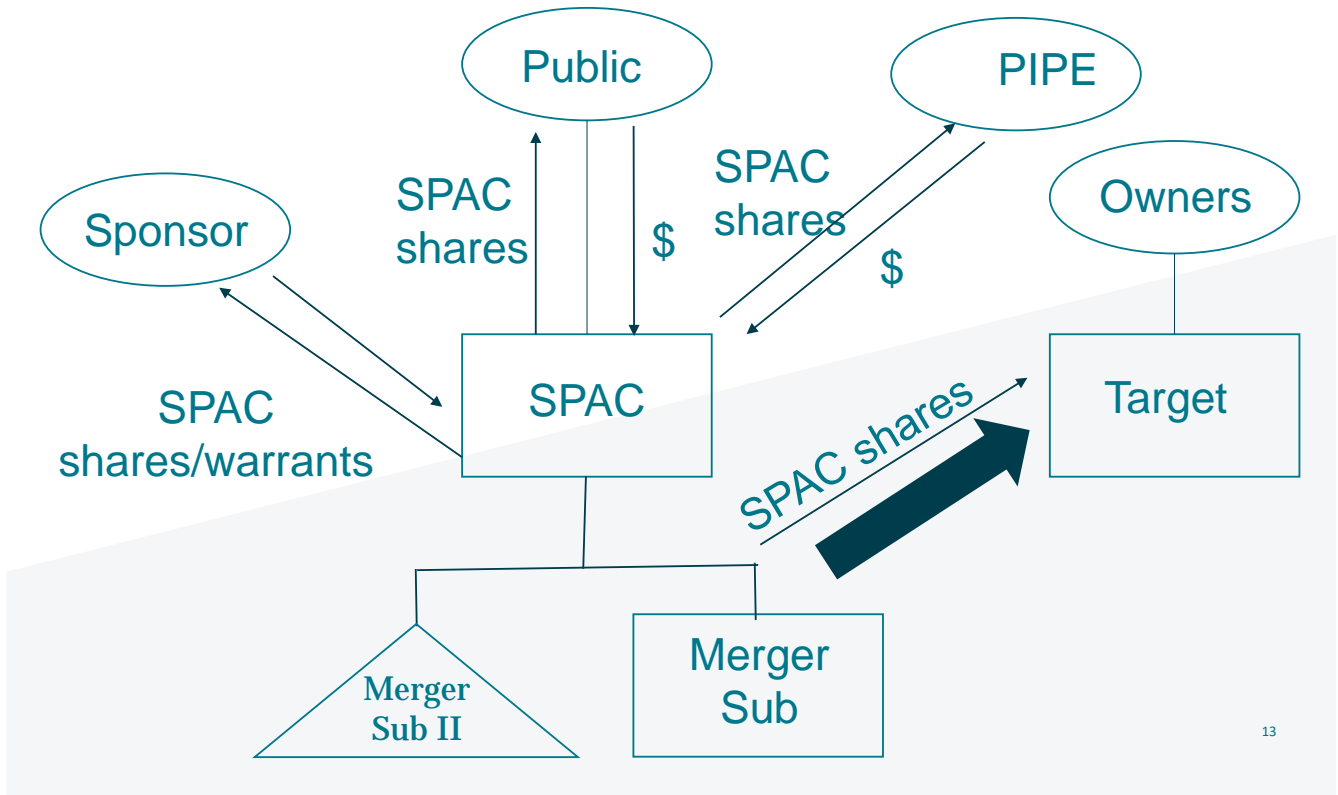
Basic de-SPAC Structures

Reverse Triangular Merger: Final Structure



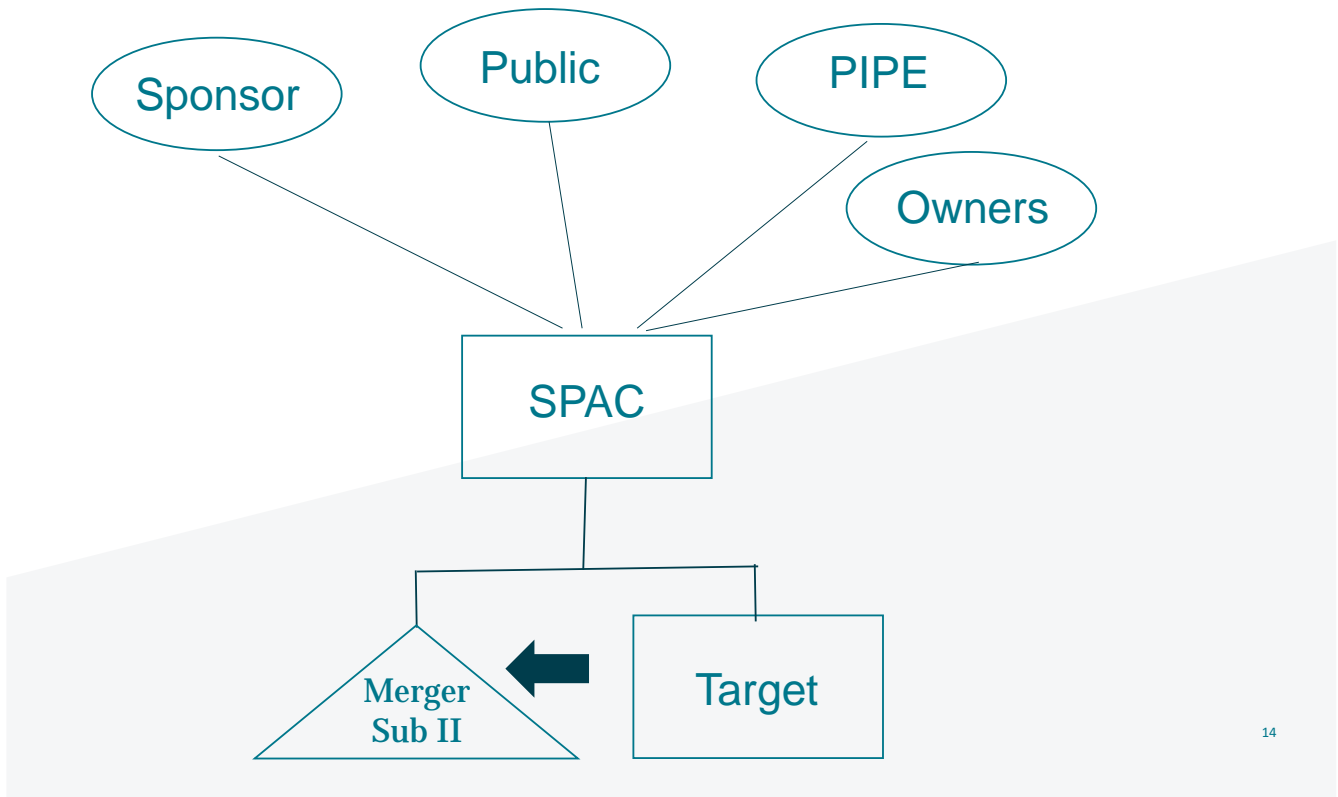
Basic de-SPAC Structures

Two-Step/Forward Triangular Merger



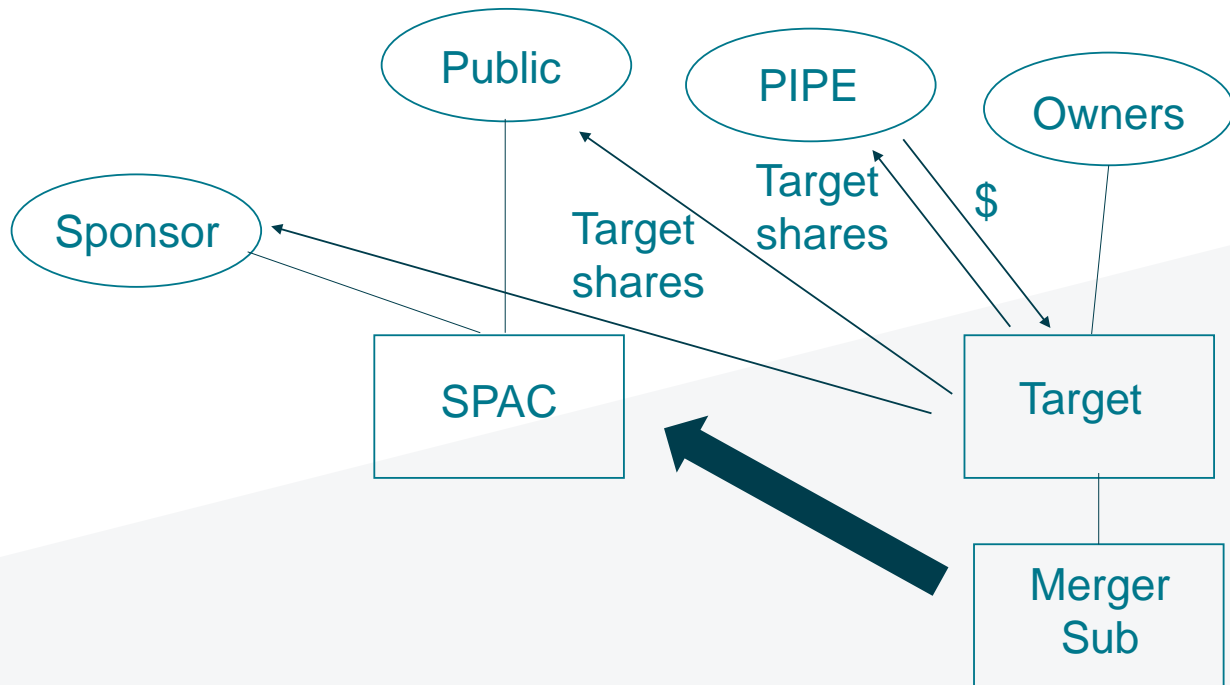
Basic de-SPAC Structures

Two-Step/Forward Triangular Merger: Resulting Structure



Basic de-SPAC Structures

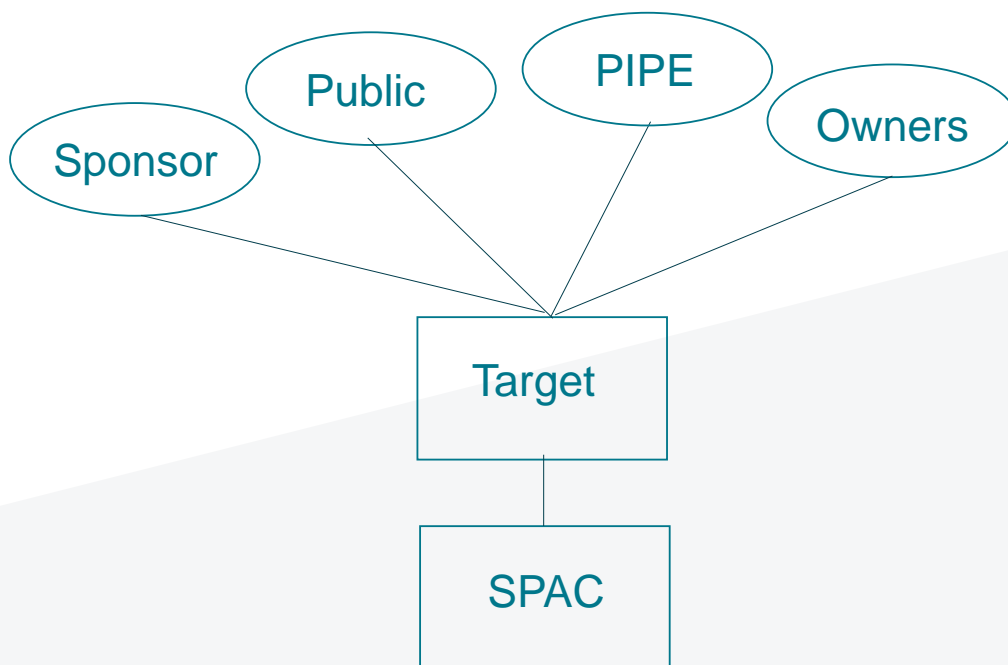
Target as Acquiror



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Basic de-SPAC Structures

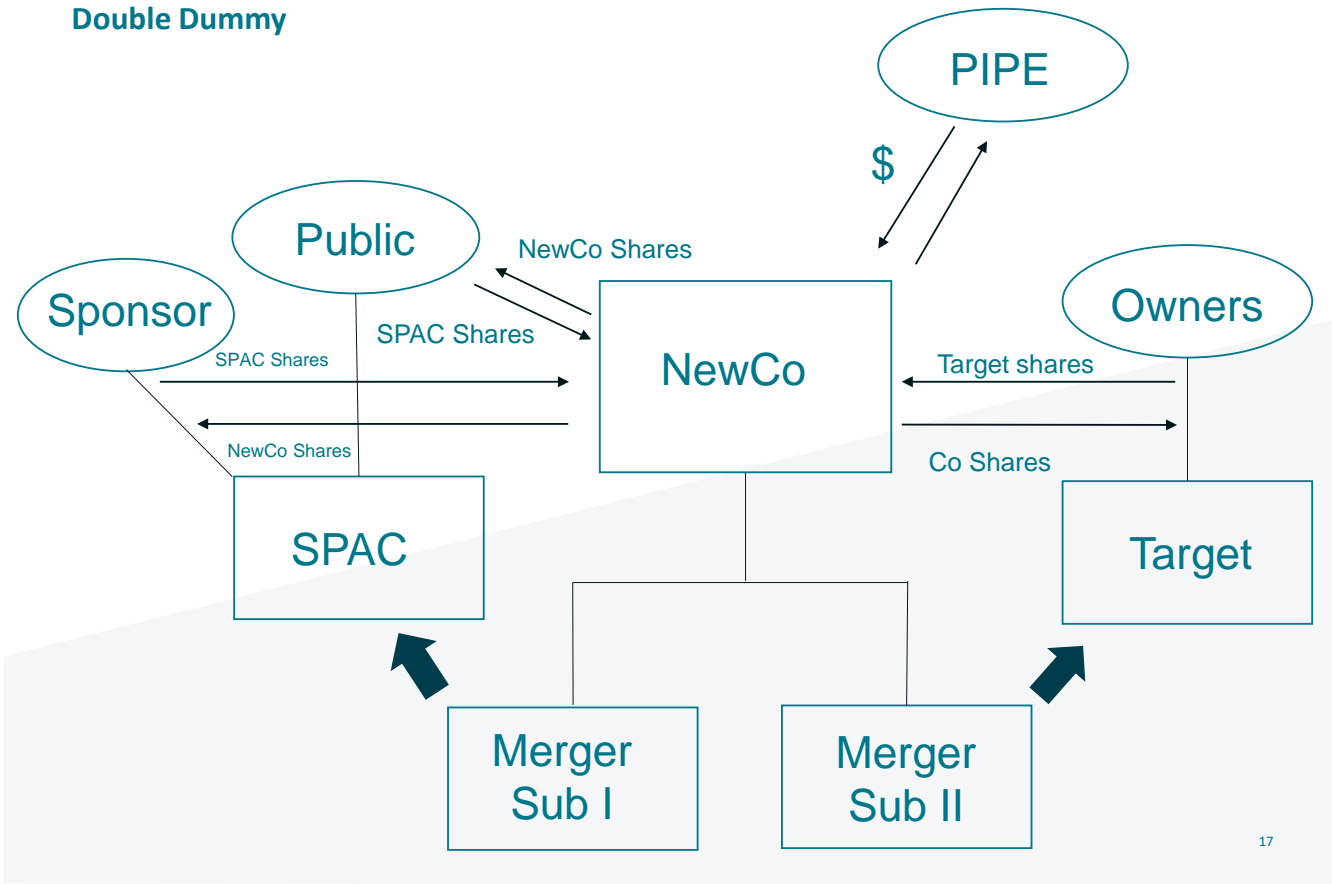
Target as Acquiror: Resulting Structure



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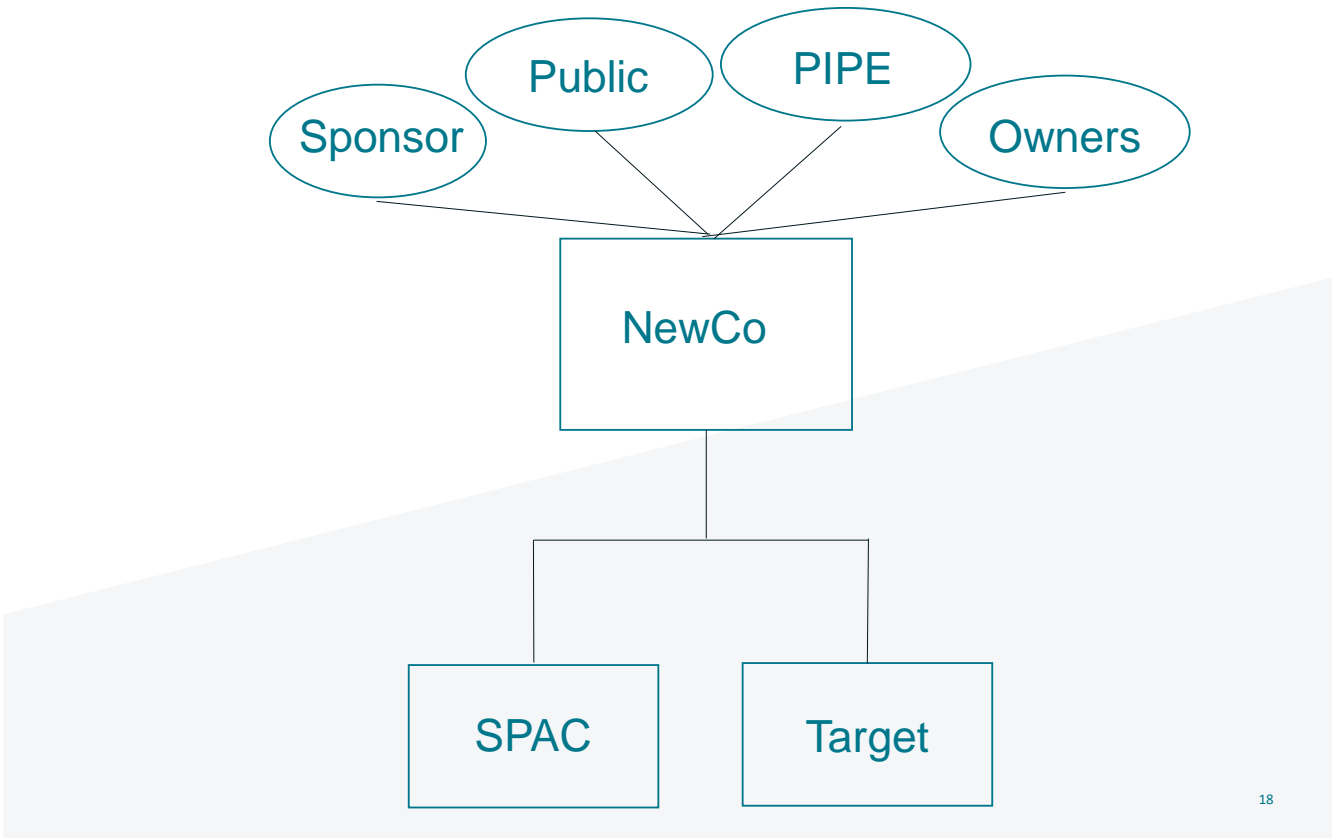
Basic de-SPAC Structures

Double Dummy



Basic de-SPAC Structures

Double Dummy: Resulting Structure



Redemption Rights

- Public investors typically buy units in the SPAC for \$10, which consists of one common share plus warrants
 - Warrants typically have an exercise price of \$11.50
 - Shares and warrants trade separately
- Once a deal is announced, public investors, but not sponsors, have the right to redeem for a proportionate share of the SPAC's trust account
- Per Barrons on September 10, 2021, the market is seeing increasing redemptions, including some deals where up to 90% of investors redeemed

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Proposed Excise Tax on Redemptions

- Apply a 2% excise tax to domestic publicly-traded corporations that redeem any securities equal to the value of securities redeemed, reduced by the sum of the value of:
 - Any newly issued securities issued during the year and
 - Any securities issued to employees during the year (including in response to an exercise of an option)
- The excise tax would not apply to:
 - Redemptions that are part of a non-recognition transaction and are not subject to recognition
 - Redeemed securities that are contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan, or an amount equal to the value of the securities are so contributed, or
 - Redeemed securities if the value of the securities does not exceed \$1 million

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Pershing Square

- Pershing Square Tontine Holdings negotiated to buy 10% of Universal Music Group for a portion of its cash
- The SEC questioned the terms of the deal on regulatory grounds
- PSTH withdrew its offer to UMG
- In August, PSTH was sued by an investor, who asserted that PSTH was really an investment company under the Investment Company Act of 1940
- PSTH also announced plans to liquidate, in exchange for cash and a warrant in “SPARC”, a “special purpose acquisition rights company”
 - Key difference: investors in a SPARC receive a unit, which represents the right to invest once the SPARC finds a business opportunity, rather than paying cash upfront and having a redemption right

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IPO Readiness

Due diligence matters

- **Sales and use taxes**
- **Withholding taxes**

Internal controls

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Whose EIN?

Directionally, Treas. Reg. §1.1502-75(d)(3) indicates that EIN of SPAC should be used, even though the consolidated group of target is treated as continuing:

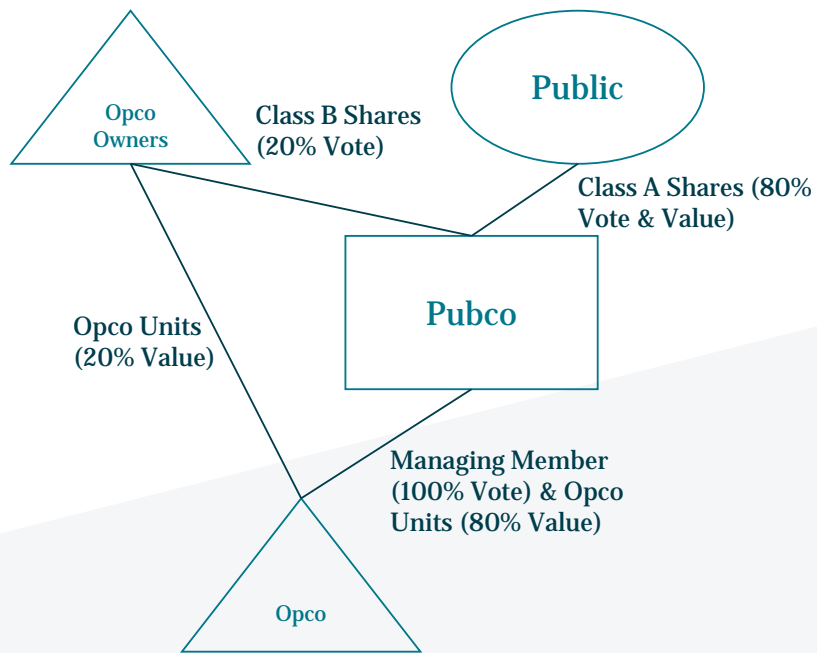
“...then any group of which the first corporation was the common parent immediately before the acquisition shall cease to exist as of the date of acquisition, and any group of which the second corporation was the common parent immediately before the acquisition shall be treated as remaining in existence (**with the first corporation becoming the common parent of the group**)” (emphasis added)

EIN block on the first page of the consolidated tax return should be filled in with SPAC's EIN, presenting name of taxpayer as:

“First Corporation” (Successor to or Acquirer of Second Corporation, EIN: XX-XXXXXXX) and Subsidiaries.”

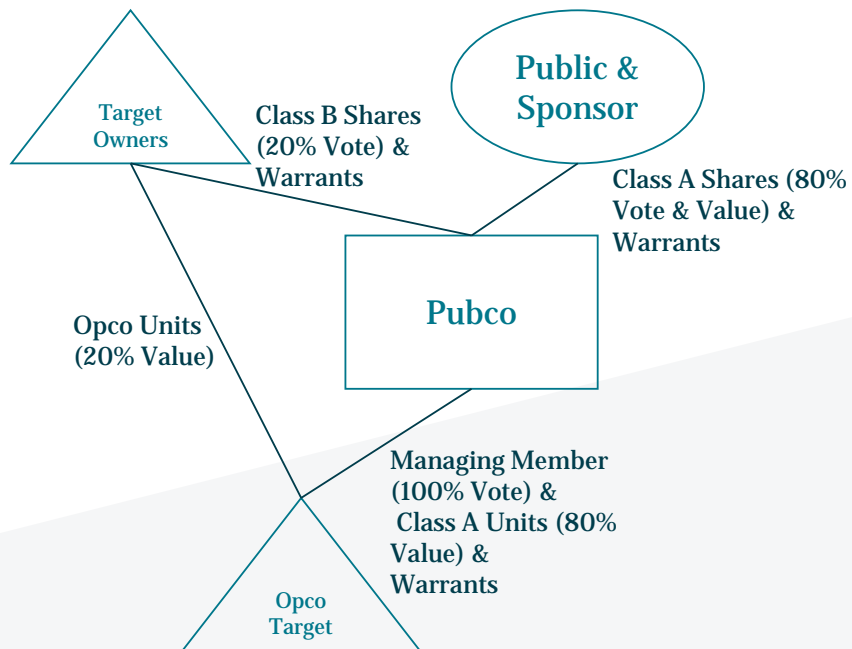
Market Landscape: UP-Cs and Tax Receivable Agreements

Traditional UP-C



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The UP-SPAC



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Traditional SPAC vs. UP-SPAC

UP-SPAC	Traditional SPAC
Sponsors remain in pass-through structure unless they want to unwind at de-SPAC	Less impediments/costs to CIC transaction
Future sell downs by sponsors generate tax basis step up for Pubco; TRA potential	No tax basis step up related to Sponsor/Founder shares; no TRA potential
More complexity (usually) (financial reporting, tax reporting, structuring)	Less complexity (usually)
More flexibility in structuring acquisitions	Less flexibility in structuring acquisitions
Founder shares are profits interests	Founder shares are not profits interests

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PTP Concerns for Opco



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If OpCo were treated as a PTP and does not satisfy the “qualifying income” test in Section 7704(d), it would...

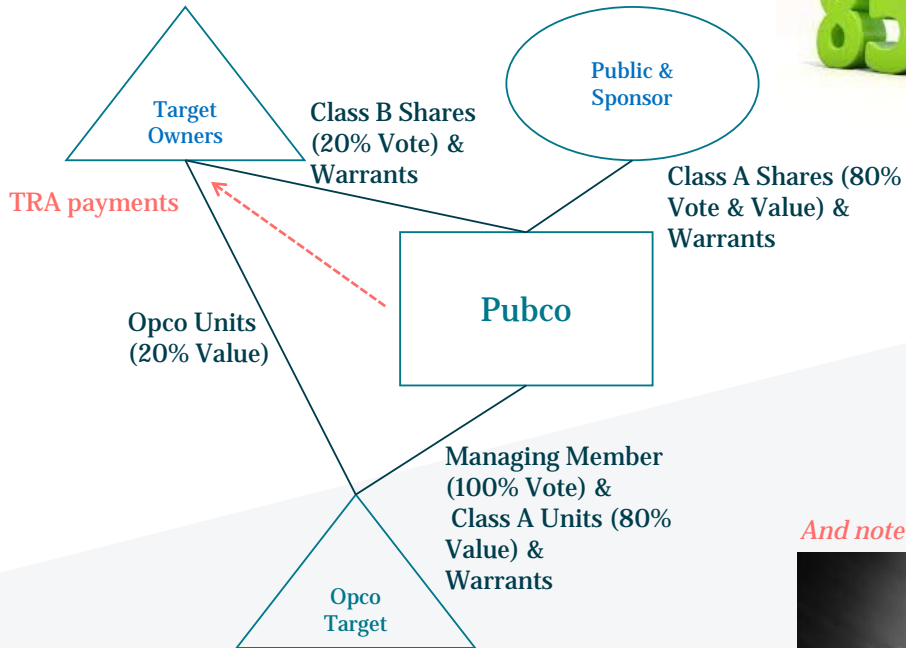
.... be subject to corporate-level tax

.... any deductions and losses would not pass through to its unitholders

Thus... defeating the purpose of the UP-C structure.

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Tax Receivable Agreement



And note...



Current Developments: Dual Class Stock

Dual Class Voting Stock

Why is dual class voting stock issued?

Company founders and leadership team can focus on long-term strategy without getting distracted by activist shareholders looking for short-term stock performance

More internal stability and harmony, which may be reassuring to customers and partners

Founders have more control takeover activity and other key strategic decisions

Implementation

Typically issued in a recapitalization in which existing regular vote stock is exchanged for new high or low vote stock

Increasingly common for only certain pre-IPO owners, such as founders and key executives, to receive high vote stock

In certain cases, all pre-IPO owners receive high vote stock, whereas new investors in IPO receive low vote stock

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Dual Class Voting Stock

Tax Consequences

Stock-for-stock exchange in one corporation usually qualifies as a reorganization under Section 368(a)(1)(E)

Treas. Reg. §1.1036-1(a)--Permits the exchange, without the recognition of gain or loss, of common stock for common stock, or of preferred stock for preferred stock, in the same corporation

“Section 1036 applies even though voting stock is exchanged for nonvoting stock or nonvoting stock is exchanged for voting stock”

Recapitalization or Section 1036 exchange must be value-for-value

If founders and key executives receive stock with value in excess of FMV of stock relinquished, the excess may be treated as compensation income subject to employment and withholding taxes

Consider the starting point—Do founders and key executives already control the Company? If so, what is the basis for their control (stock ownership, voting agreement, force of personality)?

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Dual Class Voting Stock

Tax Consequences

Rev. Rul. 74-269

- X corporation is owned 50% by father, 50% by his two sons (25% each), all voting common stock
- In anticipation of retirement, father exchanged his stock (book value \$500x) for non-voting preferred (par value \$500x), giving sons voting control of X corporation
- Holding: To the extent the exchange is value-for-value, qualifies as a tax-free reorg under Section 368(a)(1)(E)
- If father receives shares of preferred stock with FMV in excess of or less than FMV of common stock surrendered, difference will be treated as gift, compensation, satisfaction of obligations, or “whatever purpose the facts indicate”
- FMV “is a factual determination and is not necessarily the book value or par value of the stock”

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Dual Class Voting Stock

Tax Consequences

Is high vote stock worth more?

Rev. Proc. 2016-40 provides safe harbors for “control gathering” recapitalizations for purposes of Section 355, but does not address the value-for-value requirement

Rev. Rul. 69-407

- X corporation owned 70% of Y corporation, with remaining 30% owned by A and B (who do not own any stock of X corporation directly or indirectly), all voting common stock
- Y corporation recapitalizes to give X corporation 80% control

<u>Stockholder</u>	<u>Stock Relinquished</u>	<u>Stock Received</u>
X corporation	700 shares par value \$100	800 shares Class B par value \$87.50
A and B	300 shares par value \$100	200 shares Class A par value \$150

- Facts state that the exchange was value-for-value, apparently ascribing no value to additional vote received by X corporation

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Dual Class Voting Stock

Tax Consequences

Is high vote stock worth more?

Conceptually, it makes sense for economic entitlements to be main determinant of value

No law specifically requires value to be ascribed to vote

S corporation rules, which permit only one class of stock, treat stock with the same economic entitlements but different voting rights as part of the same class.

- Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock. Thus, if all shares of stock of an S corporation have identical rights to distribution and liquidation proceeds, the corporation may have voting and nonvoting common stock, a class of stock that may vote only on certain issues, irrevocable proxy agreements, or groups of shares that differ with respect to rights to elect members of the board of directors
- Treas. Reg. §1.1361-1(l)(1)

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Dual Class Voting Stock

Tax Consequences

Treas. Reg. §§ 20.2031-1(b) (estate taxes) and 25.2512-1 (gift taxes) define FMV as “the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.”

Should hypothetical “willing buyer” be treated as purchasing the low vote stock, since the high vote stock will convert to low vote stock upon transfer?

- “The willing buyer is a purely hypothetical figure and valuation does not take into account the personal characteristics of the actual recipients of the stock. The hypothetical willing buyer and seller are presumed to be dedicated to achieving the maximum economic advantage. This advantage must be achieved in the context of market conditions, the constraints of the economy, and the financial and business experience of the corporation existing at the valuation date. Moreover, in valuing stock, the rights, restrictions, and limitations of the various classes of stock must be considered ...in valuing stock, the rights, restrictions, and limitations of the various classes of stock must be considered.” *Estate of Newhouse v. Comm’r*, 94 T.C. 193 (1990) (citations omitted).

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Dual Class Voting Stock

Tax Consequences

Or is the relevant FMV the value of the stock in founder's hands, apart from its value upon sale?

- Accession to wealth? *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955)
- Founder wants voting control, and normally giving founder things that nobody else has in order to keep founder happy is compensatory
- What if founder's voting control enables her to increase the value of the shares? Or cause the board to pay her more compensation?
- Analogous to a voting proxy (albeit permanent)? Would that be comp?

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Dual Class Voting Stock

Tax Consequences

Rev. Rul. 59-60

- Outlines approach, methods and factors to be considered in valuing shares of capital stock of closely held corporations for estate tax and gift tax purposes
- Methods also apply to the valuation of corporate stocks on which market quotations are either unavailable or are of such scarcity that they do not reflect the fair market value
- Heavy emphasis on economic factors, but
 - “If the corporation has more than one class of stock outstanding, the charter or certificate of incorporation should be examined to ascertain the explicit rights and privileges of the various stock issues including: (1) *voting powers*, (2) preference as to dividends, and (3) preference as to assets in the event of liquidation”
 - “control of a corporation, either actual or in effect, representing as it does an added element of value, may justify a higher value for a specific block of stock”

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Dual Class Voting Stock

Tax Consequences

Rev. Rul. 83-120

- Amplifies Rev. Rul. 59-60 by specifying additional factors to be considered in valuing common and preferred stock of a closely held corporation for gift tax and other purposes in a recapitalization of closely held businesses
- Again, focus is primarily on economic factors, but voting rights get more attention
- “A factor to be considered in determining the value of the common stock is whether the preferred stock also has voting rights. Voting rights of the preferred stock, especially if the preferred stock has voting control, could under certain circumstances increase the value of the preferred stock and reduce the value of the common stock”

Anecdotal evidence in cases where issuer has two classes of traded stock (primarily in spin-off context) that high vote stock trades at a discount to low vote stock, which usually is ascribed to smaller public float

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Dual Class Voting Stock

Tax Consequences

Relevance of Control Premium Cases—Which way do they cut?

Dicta includes concept that control is valuable, but analysis and holdings are focused on what a buyer would pay for the stock

- *Estate of Newhouse v. Comm’r*, 94 T.C. 193 (1990) “Control means that, because of the interest owned, the shareholder can unilaterally direct corporate action, select management, decide the amount of distribution, rearrange the corporation’s capital structure, and decide whether to liquidate, merge, or sell assets”
- *Dahlgren v. United States*, 553 F.2d 434 (5th Cir. 1977) , reh’g denied, 557 F.2d 456 (1977) (control premium taken into account for purposes of Section 1239, citing to dicta in *United States v. Parker*, 376 F.2d 402 (5th Cir. 1967) “Even absent any contemplated change in management, control increases the value of an investment by protecting it. The power to change the management, even while unexercised, protects the investor with control against an abrupt change by someone else and against a gradual deterioration of the incumbent management. Therefore, in a sense, controlling shares are inherently worth more than noncontrolling shares for reasons relating solely to investment value.....” Andrews, *The Stockholder’s Right to Equal Opportunity in the Sale of Shares*, 78 Harvard L.Rev. 505, 526 (1965) [Footnote omitted].”

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Current Developments: Significant Issues in de-SPAC Transactions

SPAC Structuring: Control

- To qualify as a tax-free reorganization under Section 368(a)(2)(E) (a "reverse triangular merger"), the buyer must acquire "control" in exchange for voting stock
 - Also applies to "B reorganizations"
 - Section 368(c): ownership of stock possessing at least 80 percent of the total combined vote and 80% of the total number of shares of all other stock of the company.
 - The IRS has ruled that 80% of each class of nonvoting stock must be exchanged for voting stock.
- Voting power: generally means the right to elect directors

SPAC Structuring: Control

- Examples:
 - Corporation T has two classes of stock, Class A (voting) and Class B (non-voting). Each class has 100 shares outstanding. In a reverse triangular merger, Acquiror P exchanges each Class A share of T for 1 share of P voting stock and each Class B share for .5 shares of P voting stock and \$1. The merger does not qualify as a tax-free reorganization.
 - Same facts, except Corporation T has 90 shares of Class A stock and 10 shares of Class B stock outstanding. P acquires each Class A and Class B share for 1 share of P voting stock. Stockholder Y, who owns 3 shares of Class B stock, dissents and receives \$3 cash. The merger does not qualify as a tax-free reorganization, even though the overall consideration is 97% stock.

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SPAC Structuring: Warrants

- General rule under Section 354:
 - No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.
 - Treas. Reg. Section 1.354-1(e):
 - "Securities" includes rights issued by a party to the reorganization to acquire its stock
- Compare to Section 351: No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in Section 368(c)) of the corporation.

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SPAC Structuring: Continuity of Business Enterprise Requirement

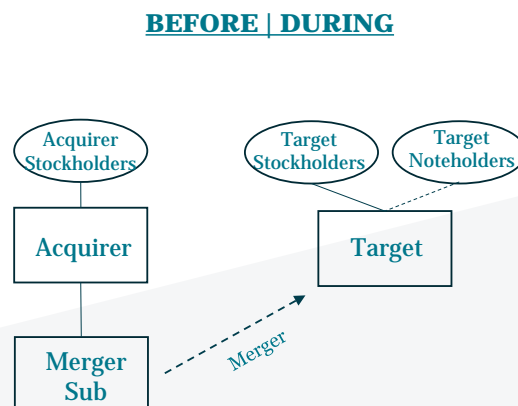
- Section 368 requires issuing corporation (P) to continue target's historic business or use a significant portion of target's historic business assets in its business
 - If T is in multiple lines of business, P must continue a "significant" line of business
 - Business assets may include stock, securities and intangibles
- What is the SPAC's historic business?
- Note that Section 351 does not have a COBE requirement

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What Happens to Outstanding Convertible Debt?

EXAMPLE 1 FACTS:

- Target has signed a merger agreement to be acquired by Acquirer in a tax-free reverse triangular merger in which the consideration is Acquirer voting stock.
- Target has convertible notes outstanding of \$150 million that will remain outstanding after the merger and will become convertible into Acquirer stock pursuant to the terms of the convertible notes.
- Acquirer will sign a joinder to become a co-obligor with respect to the convertible notes.
- Debt capacity is not speculative before or after.

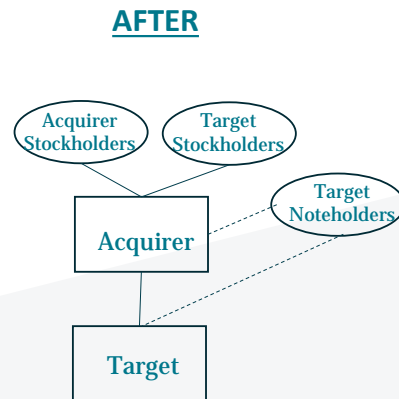


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What Happens to Outstanding Convertible Debt?

LAW:

- General rule is that alterations of a legal right or obligation that occurs by operation of the terms of a debt instrument is not a modification requiring testing for deemed exchange. §1.1001-3(c)(1)(ii).
- Exception to the general rule for alterations resulting in the substitution of a new obligor or the addition or deletion of a co-obligor. §1.1001-3(c)(2)(i).
- Addition or deletion of a co-obligor is a significant modification resulting in a deemed exchange if it results in a change in payment expectations. §1.1001-3(e)(4)(iii).
- Change in payment expectations occurs if, as a result of the transaction, there is a substantial enhancement of the obligor's capacity to meet the payment obligations under the debt, which was primarily speculative before and is adequate after; or there is a substantial impairment of the obligor's capacity to meet the payment obligations, which was adequate before and is speculative after. §1.1001-3(e)(4)(vi).

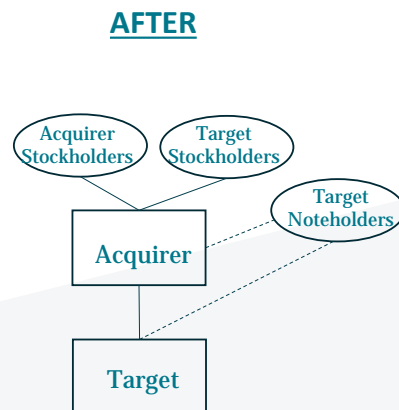


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What Happens to Outstanding Convertible Debt?

TAX CONSEQUENCES:

- Change in delivery obligation from Target stock to Acquirer stock is by operation of the terms of the debt, so under general rule, not a modification requiring testing for deemed exchange treatment under Cottage Savings regs.
- Addition of Acquirer as co-obligor does not change in payment expectations from speculative to adequate or vice versa. §§1.1001-3(e)(4)(iii) and (vi).

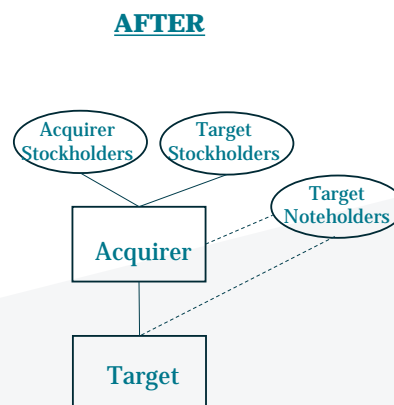


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What Happens to Outstanding Convertible Debt?

TAX CONSEQUENCES:

- When holders convert, is conversion tax-free?
- Rev. Rul. 72-265 provides that no gain is realized upon the surrender of debenture pursuant to its terms for stock of the issuer.
- In contrast, exercise of an exchange feature is taxable. Rev. Rul. 69-135.
- Cottage Savings regs state that an alteration that results in a property right that is not debt for US federal income tax purposes is a modification unless the alteration occurs pursuant to a holder's option under the terms of the instrument to convert into equity of the issuer.
- Now that Acquirer is a co-obligor and the conversion option of the debt settles for Acquirer stock, is the debt governed by the rules applicable to convertibles or exchangeables?



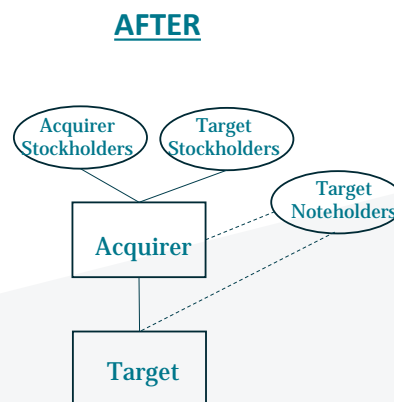
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What Happens to Outstanding Convertible Debt?

TAX CONSEQUENCES:

Possible effect of the change in conversion consideration after a change in control

In the event we undergo one of the events described above in the section titled “Description of notes—Conversion rights—Recapitalizations, reclassifications and changes of our common stock,” the conversion rate and the related conversion consideration may be adjusted such that a U.S. holder would be entitled to convert its notes into shares, property or assets other than our common stock. Depending on the facts and circumstances at the time of such event, such adjustment may result in a deemed exchange of the outstanding notes, which may be a taxable event for U.S. federal income tax purposes. Whether or not such an adjustment results in a deemed exchange of the outstanding notes, a subsequent conversion of the notes might be treated as a fully taxable disposition of the notes if the property into which the notes are convertible is no longer stock of the notes’ obligor. A U.S. holder should consult its tax advisor regarding the U.S. federal income tax consequences of such an adjustment.

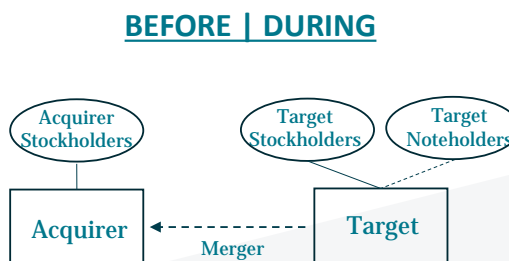


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What Happens to Outstanding Convertible Debt?

EXAMPLE 2 FACTS:

- Same facts as Example 1, except that the tax-free reorganization is structured as a direct merger of Target into Acquirer.
- Since Target will merge out of existence, instead of becoming a co-obligor, Acquirer will assume Target's obligations under the convertible notes, including conversion obligation.
- Does the structure of the merger change anything?

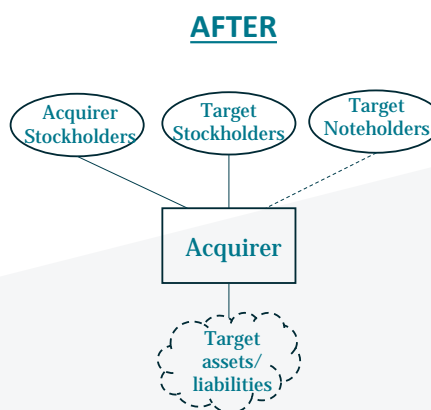


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What Happens to Outstanding Convertible Debt?

LAW:

- General rule is that substitution of a new obligor on recourse debt is a significant modification/deemed exchange. §1.1001-3(e)(4)(i)(A).
- Exception if change in obligor is pursuant to Section 381(a) transaction or acquisition of substantially all Target's assets, no change in payment expectations and no significant alteration of the debt. §§1.1001-3(e)(4)(i)(B) and (C).
- Significant alteration is an alteration that would be a significant modification but for the fact that it occurs by operation of the terms of the debt. §1.1001-3(e)(4)(i)(E).
- Is convertibility into stock of a different issuer per se significant, even though the conversion rate is adjusted in accordance with the deal terms in order to preserve the economics?
- If so, isn't that also true in Example 1?
- What if Acquirer is a SPAC? Is SPAC stock really any different than Target stock?

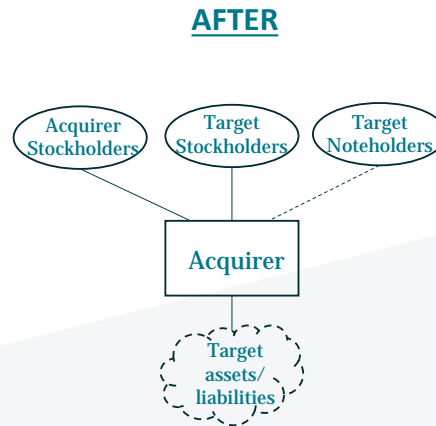


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What Happens to Outstanding Convertible Debt?

TAX CONSEQUENCES:

- If convertibility into stock of a different issuer is not per se significant, then under §1.1001-3(e)(4)(i)(B), no deemed exchange of the debt and no tax consequences for noteholders.
- Under Section 357, absent a tax avoidance purpose, Acquirer's assumption of Target's liabilities is not treated as boot and does not prevent the exchange of Target's property for Acquirer's stock and securities in the reorganization from being tax-free to Target under Section 361.

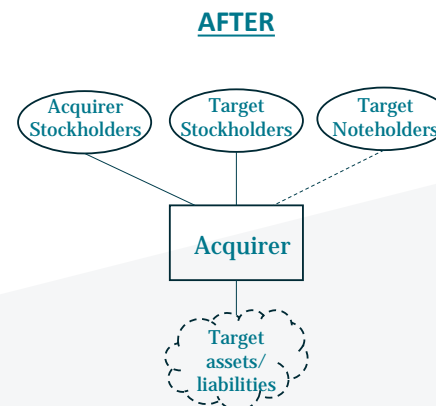


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What Happens to Outstanding Convertible Debt?

TAX CONSEQUENCES:

- If convertibility into stock of a different issuer is per se significant, then under §1.1001-3(e)(4)(i)(B), there would be a deemed retirement of Target's debt and issuance of Acquirer's debt.
- Noteholders' tax consequences generally depend on whether Target debt and Acquiring debt are securities for tax purposes. If so, exchange is generally tax-free to noteholders. §1.354-1(a); Rev. Rul. 2004-78. Convertibility weighs in favor of securities treatment.
- Ultimate conversion would be tax-free under Rev. Rul. 72-265.
- Regardless of whether tax-free for noteholders, new issue price required to be determined for Acquirer's debt, presumably based on public trading price of debt, given the amount outstanding (in excess of \$100 million). Section 1273(b)(3), §1.1273-2(b), (c) and (f).
- Could result in COD income or retirement premium.

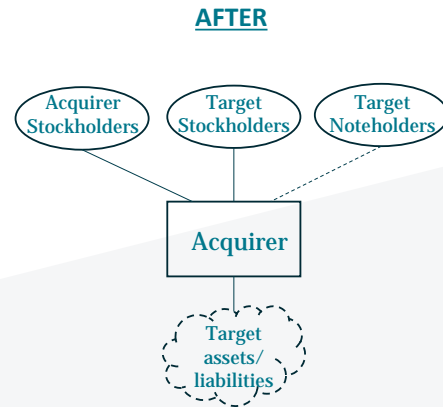


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What Happens to Outstanding Convertible Debt?

EXAMPLE 2.1:

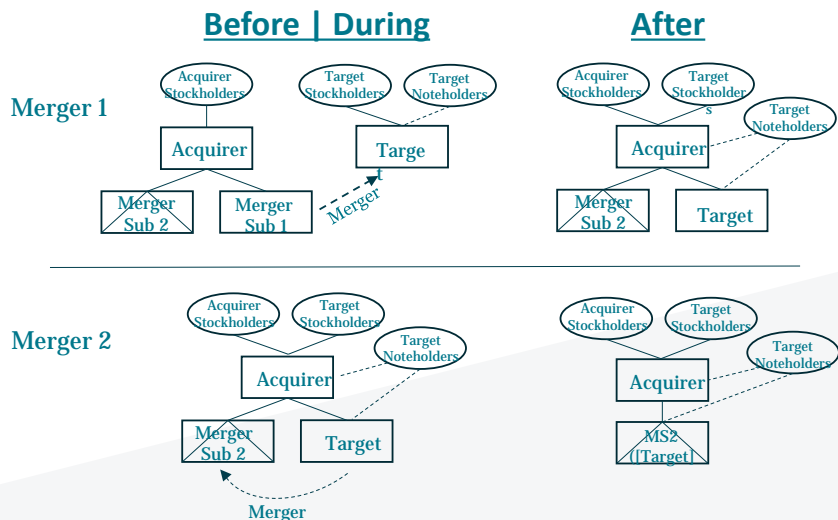
- Same facts as Example 2. Assume Target's debt has increased in value because the conversion feature is in-the-money. Aggregate principal amount is \$150 million and FMV is \$200 million.
- Assume that convertibility into stock of a different issuer is per se significant, so that there would be a deemed exchange of Target's debt and issuance of Acquirer's debt. §1.1001-3(e)(4)(i)(B),
- Face amount stays the same, but Target debt is treated as retired in exchange for issue price of Acquirer debt, based on sales prices or firm or indicative quotes. Section 1273(b)(3), §1.1273-2(b), (c) and (f).
- Premium of \$50 million is non-deductible under Section 249 to extent attributable to conversion feature.
- If stock price subsequently falls and debt is retired for its face amount (or converted into stock worth less than adjusted issue price of Acquirer debt), should Acquirer be required to recognize COD income, even though it got no tax benefit from the premium?



What Happens to Outstanding Convertible Debt?

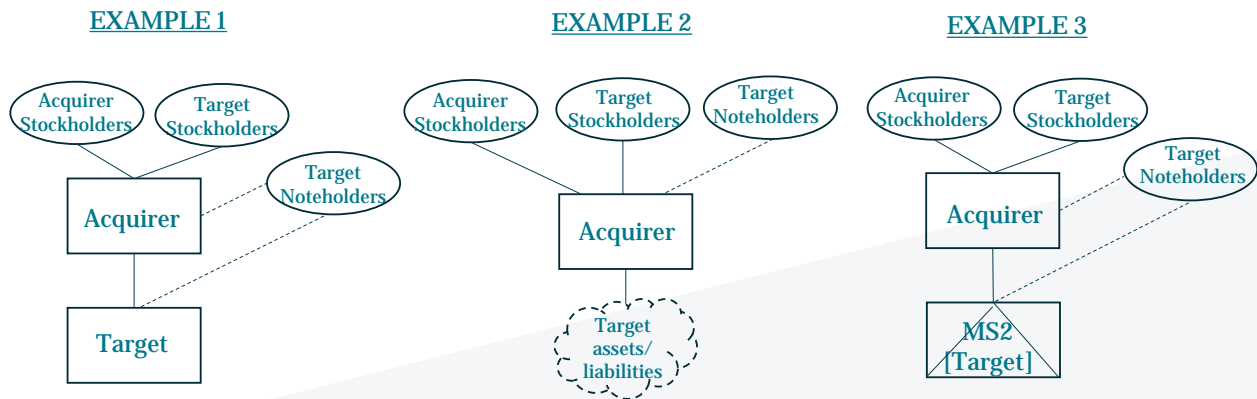
EXAMPLE 3 FACTS:

- Same facts as Example 1, except that tax-free reorganization is structured as a two-step (reverse triangular followed by forward merger of Target into Acquirer's SMLLC).
- Does the structure of the merger change anything?



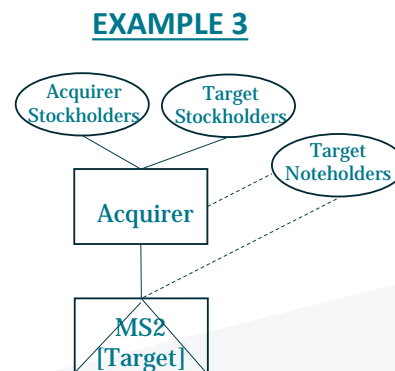
What Happens to Outstanding Convertible Debt?

Is end state of Example 3 more like Example 1 or Example 2?



What Happens to Outstanding Convertible Debt?

- Is Example 3 the addition of a co-obligor or a change in obligor for purposes of Section 1001?
- Should MS2 [Target] be treated as the same obligor as Target, given that it holds all of (and only) Target's assets and liabilities? Should MS2 [Target] be treated as the same obligor as Acquirer, given that it is a disregarded entity?
- PLRs 201010015, 200630002, 2003315001; AM 2011-003.; Cf. PLR 202050014.



Cross Border Tax Considerations: Foreign SPAC

Pros for Foreign Target	Cons for US Target
Domestication into target's jurisdiction usually does not raise U.S. tax issues (e.g., inversion rules)	Domestication to the U.S. usually required; may have tax issues
Typically able to structure for tax-free rollover under foreign law	SPAC likely a PFIC prior to acquisition so PFIC rules may apply to US investors in SPAC
Residency?	Residency?

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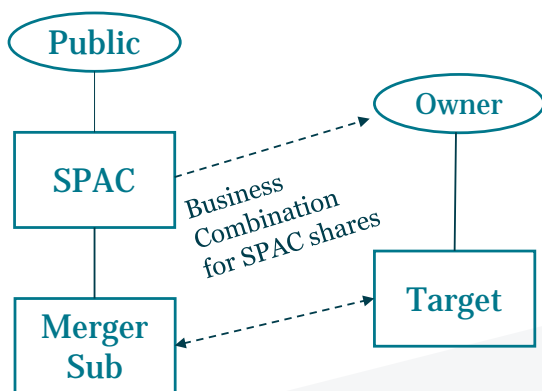
Cross Border Tax Considerations: US SPAC

Cons for Foreign Target	Pros for U.S. Target
Target income subject to U.S. tax (GILTI, 245A)	Allows for tax-free reorg with U.S. target
Foreign withholding on distributions from target to SPAC	No intercompany U.S. withholding issues
U.S. withholding on distributions from SPAC to foreign shareholders	
Domestication of SPAC into target's foreign jurisdiction (or if SPAC is target) raises inversion issues (367 and 7874)	

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SPAC NOL Issues

de-SPAC Transaction:

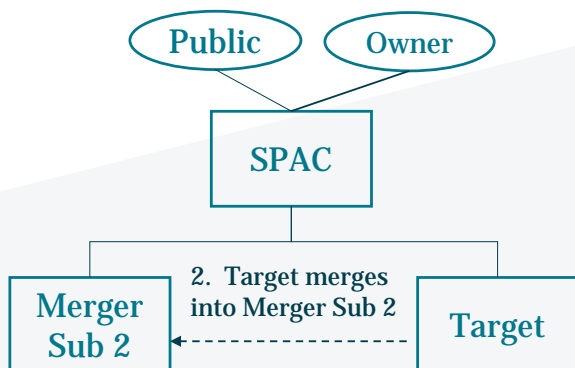
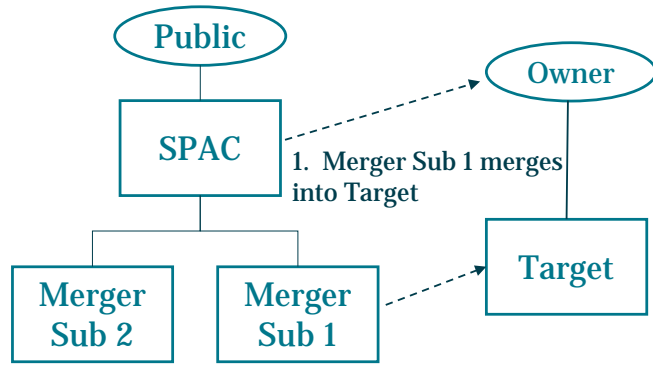


- Many de-SPAC targets have significant NOLs, making Section 382 consequences of the transaction important.
 - Consider prior equity rounds and SPAC shareholders' increase in the analysis
 - Substantial premiums in de-SPAC transactions make NUBIG/RBIG analysis important
 - Notice 2003-65 "Section 338" safe harbor continues to be valuable
 - Status of pending proposed regulations regarding NUBIG/RBIG and the possible removal/substantial modification of the "Section 338" model unclear
 - IRS has made clear that changes in this area will be prospective (i.e., apply to changes in ownership after the regulations are finalized)

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SPAC NOL Issues – Important State Considerations

Two-Step de-SPAC Transactions:



- Many de-SPAC targets have significant State NOLs and a variety of states DO NOT FOLLOW SECTION 381. As a result, when the Target merges out of existence, the NOLs in these states do not carry over.
 - Examples of such states are Connecticut, Massachusetts, New Jersey, North Dakota, South Carolina, Tennessee, Texas, and Utah
 - Other states have special rules for these transactions
 - The law in this area changes frequently, so check the latest rules

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Section 1202

- **Section 1202 provides an exclusion for eligible gain if certain conditions are met**
 - 50% when acquired 8/11/93 – 2/17/09 (subject to AMT addback). Non-excluded gain subject to 28% capital gain rate
 - 75% when acquired 2/18/09 – 9/27/10 (subject to AMT addback). Non-excluded gain subject to 28% capital gain rate
 - 100% when acquired 9/28/10 – Present. Note that Section 1202(a)(4)(C) provides that Section 57(a)(7) AMT addback of 7% of excluded gain does not apply to this period
 - House W&M bill would eliminate 75% and 100% gain exclusion for taxpayers with an AGI that equals or exceeds \$400k or that are trusts or estates and restore AMT addback of 7% of excluded gain.
- **Various shareholder-level and corporate level requirements must be met (e.g., 5-year holding period, type of business, non-C corporation shareholder, gross assets do not exceed \$50 million at issuance).**
- **Section 1202(h)(4) permits existing appreciation in QSBS to be preserved in a tax-free exchange for non-QSBS stock**

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