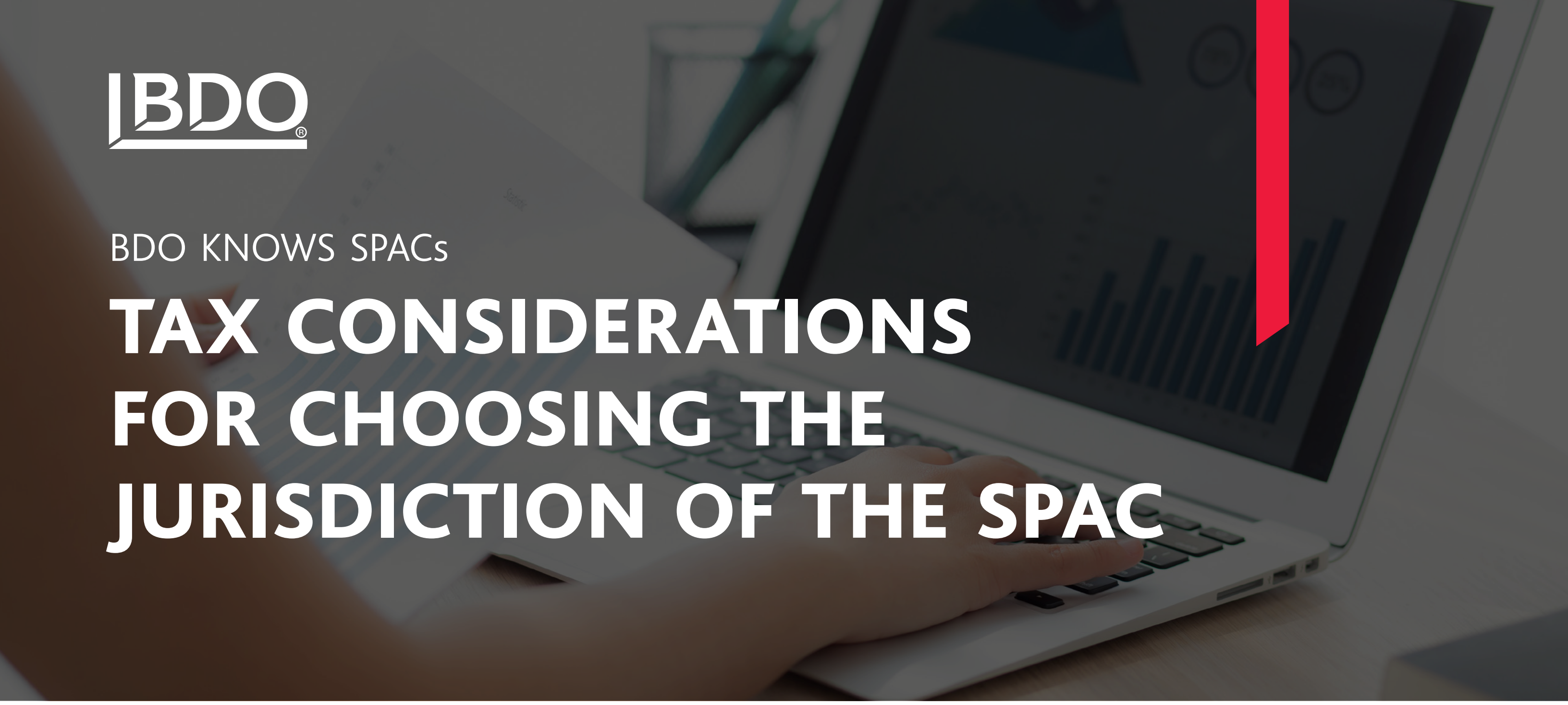

BDO KNOWS SPACs

TAX CONSIDERATIONS FOR CHOOSING THE JURISDICTION OF THE SPAC

Special Purpose Acquisition Companies (SPACs) are publicly traded companies formed for the sole purpose of raising capital through an IPO and using the IPO proceeds to acquire one or more unspecified businesses in the future. The management team that forms the SPAC (the "sponsor") forms the entity and funds the offering expenses in exchange for founder shares. There are various tax considerations and complexities that can have significant implications both during the SPAC formation process and down the road.

BDO is dedicated to helping both sponsors and target companies navigate going public through Special Purpose Acquisition Companies. In a series of articles, we'll provide an introduction outlining the current SPAC market and talk through tax, accounting, and valuation considerations to keep in mind. You can find the full series on our Special Purpose Acquisition Companies Hub Page.

SELECTING JURISDICTION FOR INCORPORATION

An important initial consideration for the management team when forming a SPAC is whether the company will be incorporated in the United States or offshore. The Cayman Islands or the British Virgin Islands are often used for offshore incorporation due to their favorable tax environments, although the choice of jurisdiction generally depends on the jurisdiction of the likely target. If the target will be a U.S. corporation, a foreign SPAC will create complexities and potential tax leakage with respect to certain types of payments from the U.S. target to the SPAC.

For example, payments from the U.S. target to a foreign SPAC, such as dividends or interest, should generally be subject to a 30% U.S. withholding tax unless the rate is reduced or eliminated under a tax treaty between the U.S. and the SPAC's country of tax residence—and assuming the SPAC recipient qualifies for benefits under the treaty. Determining treaty qualification can be complex, and treaties do not always reduce the withholding tax to zero. Further, the U.S. does not have an income tax treaty with the Cayman Islands or the British Virgin Islands.

Conversely, if the target is a foreign corporation it may be inefficient to have the foreign target owned by a U.S. SPAC as the U.S. SPAC would be subject to unfavorable U.S. anti-deferral rules (e.g., Subpart F and GILTI) and complex reporting obligations with respect to the foreign target.

Changing the Jurisdiction of a SPAC After Formation Can Be Difficult

For example, if a SPAC formed in the United States seeks to expatriate because it is acquiring a foreign target, depending on how the outbound expatriation is structured, the SPAC may continue to be treated as a U.S. corporation for all federal tax purposes or be subject to other unfavorable anti-inversion rules. The expatriation can also lead to U.S. income tax at the level of the SPAC and in certain instances, to its shareholders as well.

If a foreign SPAC seeks to reincorporate in the United States because it is acquiring a U.S. target, both the SPAC and its shareholders could potentially be subject to U.S. tax in the domestication transaction, and each party must be considered separately.[1] Depending on how the transaction is structured, the SPAC and its shareholders could also be subject to tax in their jurisdictions on the domestication transaction.

Passive Foreign Investment Company Implications

The domestication of a foreign SPAC may give rise to significant, complex issues under the passive foreign investment company (PFIC) rules. A foreign corporation is a PFIC if at least 75% of its gross income for the tax year is passive income or if at least 50% of its assets for the tax year produce or are held for the production of passive income. Passive income generally includes dividends, interest, some rents and royalties, and gains from the disposition of passive assets.

Once PFIC status is acquired, it cannot be lost in subsequent years in which the foreign corporation no longer satisfies the tests, unless the foreign corporation is "purged" of its PFIC taint, or certain elections are made for the first year of the U.S. investor's holding period during which the foreign corporation is a PFIC. If a foreign corporation is a PFIC, U.S. investors in the PFIC are subject to unfavorable taxing regimes on income attributable to the PFIC and may also be subject to certain annual reporting obligations with respect to their ownership interests in the PFIC. If a SPAC is a PFIC, holders of SPAC warrants can also be subject to unfavorable PFIC rules and may not be able to make certain elections to mitigate some of the negative tax implications that may arise on a domestication transaction of the SPAC.

BDO INSIGHT

Selecting an appropriate jurisdiction is a decision that should be carefully considered by management before the SPAC is created. Tax implications based on this decision can have a significant effect on investors' bottom lines.

1 See Section 367(b) and the regulations thereunder for additional details.

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