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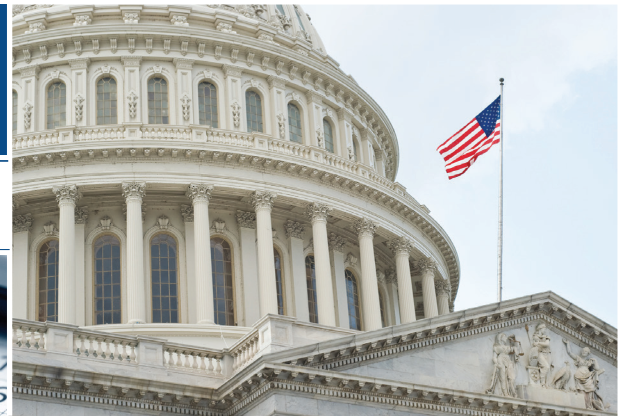

Federal Tax ADVISORY ▪

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SPAC Redemptions

Special purpose acquisition companies (SPACs) face many tax challenges. A current issue is whether a SPAC's redemption of shareholder stock is subject to the new 1% excise tax. The short answer is yes, but there are exceptions.

Under Section 4501(a), a "covered corporation" (any U.S. corporation whose shares are publicly traded) must pay a tax equal to 1% of the fair market value of any stock of the corporation that is repurchased by the corporation during the taxable year. Section 4501(c)(3) provides that the amount taken into account under Section 4501(a) is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including the fair market value of any stock issued or provided to employees of the corporation or employees of a specified affiliate of the corporation during the taxable year. This is known as the "netting rule."

Redemptions can occur in two situations. First, shareholders usually have a right to redemption if the shareholders vote to extend the period for the SPAC to find an acquisition target. Second, shareholders usually can be redeemed when the acquisition target is found but the shareholders don't like it. In either case, the SPAC is ongoing—at least for a while—and not liquidating.

The stock redemption excise tax does not apply to complete corporate liquidations, but there's a caveat. IRS Notice 2023-2, which is the only guidance on the excise tax so far, allows the exemption by not treating liquidating distributions as a "repurchase" under Section 4501. (See Section 3.04(4)(b)(i) of the notice).

However, for a corporation that is at least 80% owned (by vote and value) by another corporation and has one or more minority shareholders, liquidating distributions to the minority shareholders are be treated as a repurchase under Section 4501. (See Section 3.04(4)(a)(v) of the notice.)

For redemptions on an extension of the life of a SPAC, the redemption either will or will not be part of a complete liquidation. If not, and if the SPAC issues its stock to target shareholders, under the netting rule, the stock issuance can net down the amount of stock redemptions subject to the excise tax.

But those are the cases where advisers should focus on the applicability of the excise tax because Section 3.08(4) of the notice provides that certain stock issuances are disregarded when applying the netting rule. For example, the stock of a covered corporation distributed by the corporation to its shareholders as a stock dividend is treated as not issued under the netting rule. Stock issued by a covered corporation to certain affiliates is also ignored under the netting rule.

There are other considerations if the issuer of the stock to be repurchased is a foreign corporation. For example, if a foreign corporation whose shares are publicly traded indirectly redeems its shares by having its U.S. affiliate purchase them from a shareholder that is not a U.S. affiliate of the issuer, under Section 4501, the IRS could treat the U.S. affiliate as a covered corporation redeeming its own stock and impose the excise tax on the purchase.

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