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SPAC Considerations: New Regs Proposed for Stock Repurchase Excise Tax

On April 9, the Treasury Department and Internal Revenue Service **issued** two sets of proposed regulations (the Proposed Regulations) regarding the application of the excise tax on repurchases of corporate stock and the reporting and payment of such taxes. The Proposed Regulations generally follow the approach of Notice 2023-2 (the Notice), which was issued Dec. 27, 2022, but modify and clarify some of the rules in the Notice. This GT Alert focuses on certain aspects of the Proposed Regulations that are relevant to special purpose acquisition companies (SPACs).

Summary

- The Treasury Department and IRS decided it was neither necessary nor appropriate to adopt special rules for SPACs in the Proposed Regulations. Thus, SPACs are generally subject to the rules of the Proposed Regulations in the same manner as other taxpayers.
- The Proposed Regulations do not provide transition relief from the stock repurchase excise tax for payments in connection with merger and acquisition (M&A) transactions pursuant to a binding commitment entered into prior to the enactment date of the tax. Similarly, no transition relief is provided for redemptions by SPACs formed prior to the enactment date.

- The Proposed Regulations do not provide an exception for redemptions of stock subject to a mandatory redemption provision or unilateral put option, which is a type of stock commonly issued by SPACs.
- The Proposed Regulations do not expand the netting rule to apply to de-SPAC transactions in which the SPAC is not the acquiring corporation, such as “double dummy” transactions.
- SPACs generally will not be required to pay stock repurchase excise taxes in respect of 2023 repurchases until after the final regulations are published.

No Specific Relief for SPACs

In the preamble to the Proposed Regulations, the Treasury Department and IRS describe various comments that were submitted in response to the Notice regarding the application of the stock repurchase excise tax to transactions involving SPACs. These comments noted that SPAC redemptions, which essentially constitute a return of a shareholder’s capital, are fundamentally different from conventional share repurchases.

While acknowledging these comments, the Treasury Department and IRS decided it was neither necessary nor appropriate to adopt special rules for SPACs in the Proposed Regulations. SPACs are, therefore, generally subject to the rules of the Proposed Regulations in the same manner as other taxpayers.

No Transition Relief for M&A Transactions Entered Into, or SPACs Formed, Prior to Enactment Date

The stock repurchase excise tax was codified by enactment of legislation known as the Inflation Reduction Act (the IRA) on Aug. 16, 2022. Under the IRA, the tax is imposed on repurchases made after Dec. 31, 2022. Thus, the stock repurchase excise tax generally applies to repurchases that occur after the effective date (i.e., Jan. 1, 2023), even if such repurchases occur pursuant to a binding commitment entered into before the enactment date (i.e., Aug. 16, 2022). In other words, redemptions of stock that was issued before the enactment date would generally be subject to the tax even though the tax did not exist when the stock was issued.

The Treasury Department and IRS received requests for transition relief in this regard, including for (i) payments in connection with M&A transactions pursuant to a binding commitment entered into prior to the enactment date, and (ii) redemptions by SPACs formed prior to the enactment date. However, relying on the plain language of the statute, the Treasury Department and IRS determined that such transition relief “would not be appropriate.”

No Relief for Repurchases of Mandatorily Redeemable Stock

For purposes of the stock repurchase excise tax, the definition of “stock” is critical. The Notice generally defines “stock” broadly as “any instrument issued by a corporation that is stock or is treated as stock for Federal tax purposes at the time of issuance.”

In response to the Notice, the Treasury Department and IRS received comments recommending that various types of financial instruments — including stock subject to a mandatory redemption provision or unilateral put option — be excluded from the definition because repurchases of those instruments do not

implicate the policy concerns underlying the tax. Ultimately, however, the Treasury Department and IRS declined to exempt mandatory redemptions from the scope of the tax.

The Netting Rule in Certain de-SPAC Transactions

Very generally, the “netting rule” provides that a corporation’s stock repurchase excise tax base is reduced by the fair market value of any issuances of the corporation’s stock during the same taxable year. Thus, if a SPAC is the acquiring corporation in a de-SPAC transaction, the SPAC will potentially be able to offset its stock redemptions with stock issuances to the target company’s shareholders.

In certain de-SPAC transactions, however, the SPAC is not the acquiring corporation. One common example is a so-called “double dummy” transaction in which a newly formed entity acquires both the SPAC and the target company. In such a transaction, the newly formed entity (and not the SPAC) is the issuer of the stock consideration. The Treasury Department and the IRS received comments observing that such issuances are functionally equivalent to issuances by the SPAC and should therefore be taken into account for purposes of the netting rule. However, the Treasury Department and IRS decided against expanding the netting rule in this context.

Time for Filing Return and Paying Tax

For corporations with a taxable year ending after Dec. 31, 2022, and on or before the date of publication of final regulations, the Proposed Regulations generally provide that the stock repurchase excise tax return must be filed by the due date for the first full calendar quarter after the date the final regulations are published.

To illustrate with an example from the Proposed Regulations, assume that a corporation with a taxable year ending Dec. 31 makes stock repurchases during its 2023 taxable year. Assume further that the final regulations are published Oct. 16, 2024. In such circumstances, the corporation would be required to file the stock repurchase excise tax return for its 2023 taxable year by the due date for excise tax returns in respect of the fourth quarter of 2024 (i.e., Jan. 31, 2025).

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