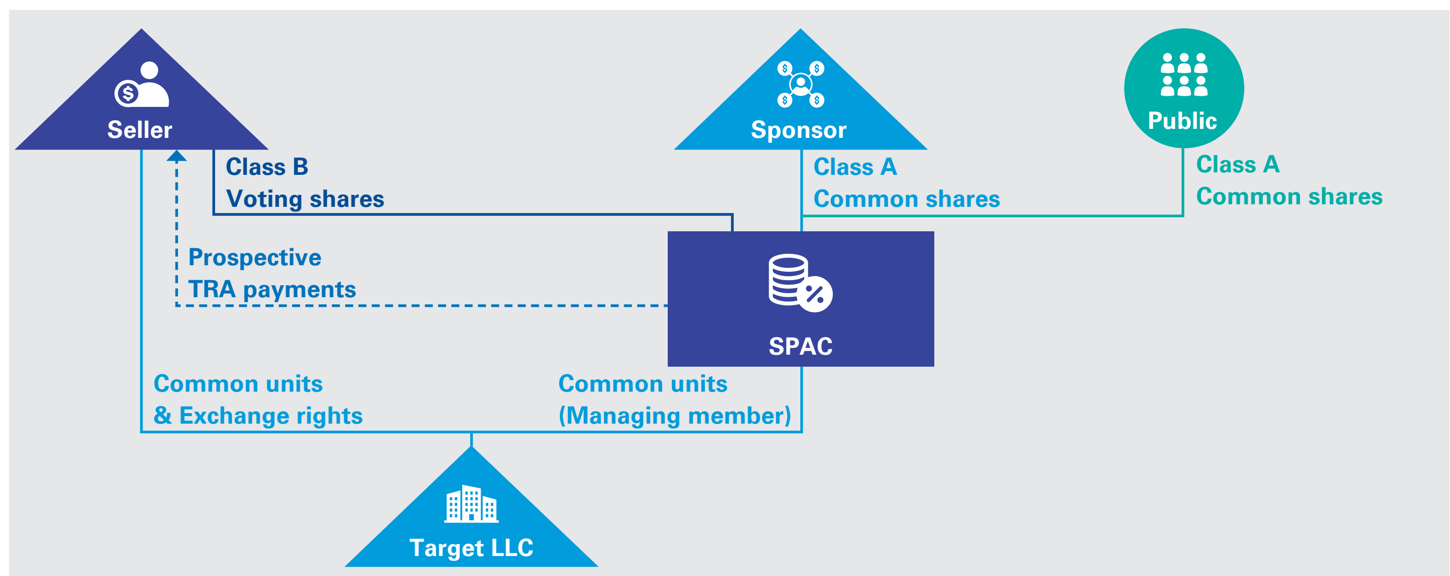
SPAC insights: UP-C tax structuring

In a SPAC transaction, how the acquisition is structured can have a big tax impact. If the target company in a SPAC acquisition is a partnership for U.S. federal income tax purposes, the SPAC umbrella partnership C corporation (UP-C) provides a number of benefits. However, the SPAC UP-C has some distinct complexities that can result in unique tax and accounting consequences.

The SPAC UP-C

In a SPAC UP-C structure, the operating company is a partnership ("Target LLC" in Exhibit 1) that is co-owned by the public corporation ("SPAC") and the pre-merger owners of the target company ("seller" – which receives Class B voting interests in the SPAC). Also, the structure likely contains exchange rights, whereby the seller has a right to have its Target LLC partnership units redeemed in exchange for the SPAC's stock or cash. Finally, these structures also typically include the use of a tax receivable agreement (TRA), which requires the SPAC pay a percentage of cash tax savings delivered by the seller in connection with the transaction (e.g. additional tax deductions from increased tax basis, net operating losses, etc.—"Prospective TRA payments").

Exhibit 1. SPAC UP-C structure



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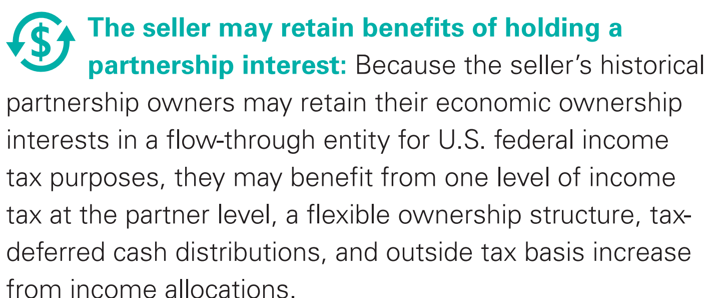
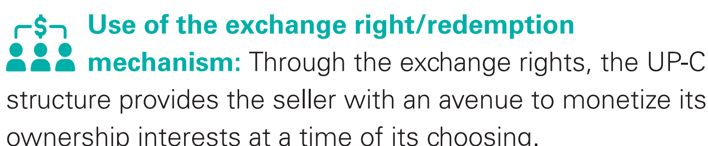
Benefits of a SPAC UP-C

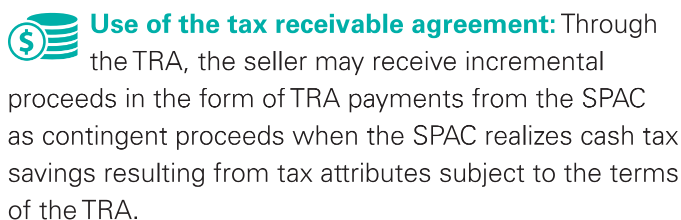
The key value drivers from an UP-C structure are the following:



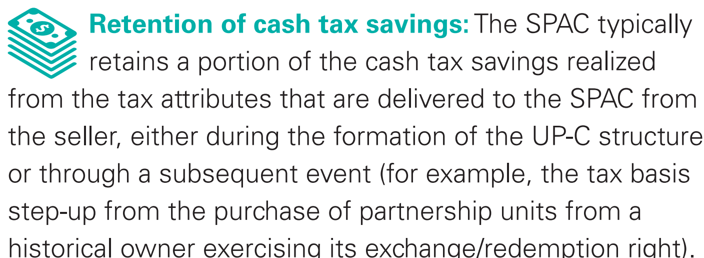
The seller may retain benefits of holding a partnership interest: Because the seller's historical partnership owners may retain their economic ownership interests in a flow-through entity for U.S. federal income tax purposes, they may benefit from one level of income tax at the partner level, a flexible ownership structure, tax-deferred cash distributions, and outside tax basis increase from income allocations.



Use of the exchange right/redemption mechanism: Through the exchange rights, the UP-C structure provides the seller with an avenue to monetize its ownership interests at a time of its choosing.



Use of the tax receivable agreement: Through the TRA, the seller may receive incremental proceeds in the form of TRA payments from the SPAC as contingent proceeds when the SPAC realizes cash tax savings resulting from tax attributes subject to the terms of the TRA.



Retention of cash tax savings: The SPAC typically retains a portion of the cash tax savings realized from the tax attributes that are delivered to the SPAC from the seller, either during the formation of the UP-C structure or through a subsequent event (for example, the tax basis step-up from the purchase of partnership units from a historical owner exercising its exchange/redemption right).

Accounting consequences of a SPAC UP-C

The accounting and financial reporting of a SPAC merger in the form of an UP-C will depend on whether the SPAC or the target company is the accounting acquirer. Broadly speaking[1]:

If the target company in an UP-C structure meets the definition of a variable interest entity (VIE)[2] with the SPAC as the primary beneficiary, this would make the SPAC the accounting acquirer.

This results in "business combination" accounting, adjusting the target company's assets, liabilities and noncontrolling interests to fair value.

If the target company does not meet the definition of a VIE because the SPAC is typically a shell company and the operations and management of the combined entity often come from the target company, the target frequently becomes the accounting acquirer of the SPAC.

This results in "reverse recapitalization" accounting, which does not step up the basis of the assets and liabilities of the target company to fair value.

This difference can have profound impact on the Day 1 accounting and reporting requirements, as well as on the ongoing financial results of the combined company. This is due to the potential for increased depreciation and amortization of tangible and intangible assets either recognized or increased to fair value when the SPAC is the accounting acquirer.

In addition to accounting acquirer considerations, the complexities of the tax structuring often present challenges in the financial accounting around the resulting TRA and accounting for income taxes.

[1] The various accounting rules on the criteria for the accounting acquirer may make the actual determination much more complex. For example, the first step in evaluating the accounting acquirer is to determine whether the entity being legally acquired is a VIE because only the primary beneficiary in a VIE can be considered the accounting acquirer. See Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805, *Business Combinations* (ASC 805) and FASB ASC Topic 810, *Consolidation* (ASC 810).

[2] The target company frequently would be akin to a limited partnership if it is managed by a sole general partner or managing member (the SPAC), which would cause it to be a VIE. If the target company is structured to be more akin to a corporate form, the target company would not likely be a VIE.

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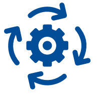
Bottom line

The UP-C structure provides benefits to both parties, including all the general benefits of operating in a flow-through structure, but also entails significant accounting consequences. Both parties in a SPAC merger thus need to be aware of how the rules apply and work closely with advisors to mitigate or avoid unnecessary risks.

SPAC transaction lifecycle



A SPAC has a typical lifespan of 18-24 months, but completing a merger with a SPAC can take as little as six months after the signing of an initial agreement. This paper focuses on the pre-deal phase of tax structuring. But across the lifecycle of a SPAC transaction, many other issues will arise. For more on these, visit the KPMG SPAC Intel Hub.

Pre-deal | **Pre-close** | **Post-close**

Milestones: LOI signed; Merger agreement signed; Proxy statement signed; Proxy statement effective; Vote; Deal close; Super 8-K filed

- Liquidity options
- SPAC diligence
- Contingent consideration
- Tax structuring
- Financing—debt
- Financing—PIPE
- Marketing/roadshow
- Proxy and SEC registration statements
- SEC comments
- Super 8-K
- Public company readiness assessment
- Public company readiness execution
- Public company ongoing operations
- Strategy growth

KPMG cross-functional support (tax, diligence,accounting advisory, modeling, IT systems, SOX)

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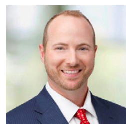

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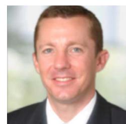

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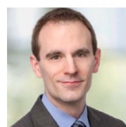

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