



**VIRTUAL 13TH ANNUAL  
U.S. AND LATIN AMERICA  
TAX PRACTICE TRENDS**

# Current State of M&A Market

June 22, 2021



# The Panel

- **Co-chairs**

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# Objectives

- **Discussion of main issues related to SPACs in US**
  - Brief considerations for Brazil, Mexico and Colombia
- **Analysis of recent approach of private equity**
  - Main structures in Brazil, Mexico and Colombia
  - Comments from US perspective

# SPACs Agenda

- SPAC Introduction
- SPAC Formation Issues
- De-SPAC Tax Structuring
  - Basic Transaction
  - Discussion of issues in Brazil, Mexico, and Colombia

# SPAC Introduction

## Brief Overview

- A Special Purpose Acquisition Company (“SPAC”) is a blank-check company with no operations, formed for the sole purpose of raising equity capital through an initial public offering (“IPO”) to acquire an operating business (a “business combination”)
  - Typically formed by well known private equity/hedge fund sponsors relying on their reputation and experience to attract investors
- Significant portion of IPO proceeds are placed in a trust account and are used to fund expenses and the eventual business combination
  - Trust account may be interest bearing in certain circumstances
- Specified time period (typically 18-24 months) to complete the business combination following the IPO, otherwise the SPAC is liquidated and cash (plus interest, if any) is returned to shareholders

# SPAC Introduction

## Brief Overview

- SPAC IPO volume so far in 2021: \$78.7 bn (251 IPOs)
- By comparison, SPAC IPO volume in recent years:
  - 2020: ~ \$79 bn (240+ IPOs)
  - 2019: ~ \$13.6 bn (59 IPOs)
  - 2018: ~ \$10.7 bn (46 IPOs)
  - 2011: ~ \$1.5 bn (10 IPOs)

# SPAC Introduction

## Focus on Latin America emerging growth industries

- Latin American backed SPACs – Q1 of 2021 has seen at number of Latin America-focused venture capital firms, asset managers, and bank founders have raised or announced SPAC IPOs worth more than \$1.46 billion
  - Excelsa Acquisition Corp (Cayman) - \$250 million IPO to target businesses across financial services, healthcare, retail, education, entertainment and consumer goods industries in Latin America
    - Unit consists of one Class A common share and one third of one warrant
  - DILA Capital Acquisition Corp (Delaware) - \$55 million IPO to target businesses with significant operating technological advantage that are headquartered in Latin America, as well as businesses located in the United States which cater to the Hispanic community
    - Unit consists of one Class A common share and one whole warrant
  - Alpha Capital Acquisition Corp (Cayman) – \$200 million IPO to target Latin American-focused technology businesses
    - Unit consists of one Class A common share and one half of one warrant

# SPAC Introduction

## Capital Structure – *Publicly-held Securities*

- SPACs typically raise capital by issuing “units” to public investors in an IPO
  - Each unit generally consists of one common share and warrants
    - Common shares and warrants trade separately
    - Public warrants are exercisable and callable at a specified premium to issuance price
- In connection with the business combination, common shares are redeemable at the holders’ option for their proportionate share of the funds in trust
- Often, business combinations must receive majority shareholder approval and cannot be consummated if more than 30% of the public shareholders vote against and elect instead to exercise their redemption rights



# SPAC Introduction

## Capital Structure – *Sponsors' Securities*

- Sponsors invest nominal capital up front for “Sponsor Shares” prior to the SPAC’s IPO
  - Sponsor Shares have limited liquidity, as insiders typically cannot sell for a lock-up period (1-3 years following the business combination)
  - In certain deals, Sponsor Shares entitle Sponsors to control the SPAC board/elect directors prior to a business combination
  - Sponsors waive redemption rights afforded to public shareholders, agree to vote to approve business combination, and waive rights to liquidating distributions from trust for failed business combination
- Sponsor Shares generally entitle holders to SPAC equity equal to 20% of post-IPO common shares value (the “Sponsor Promote”)
  - Largest SPAC ever (\$4BN) did not issue any Sponsor Promote
  - Sponsor Promote may be economically “better” than typical private equity carried interest as it sometimes covers contributed capital and future appreciation
- “Sponsor warrants” are typically issued in a private placement concurrently with the IPO and are substantially similar to the public warrants
  - Unlike the public warrants, Sponsor warrants are typically not callable while still held by the initial holders
  - May be subject to a lock-up period

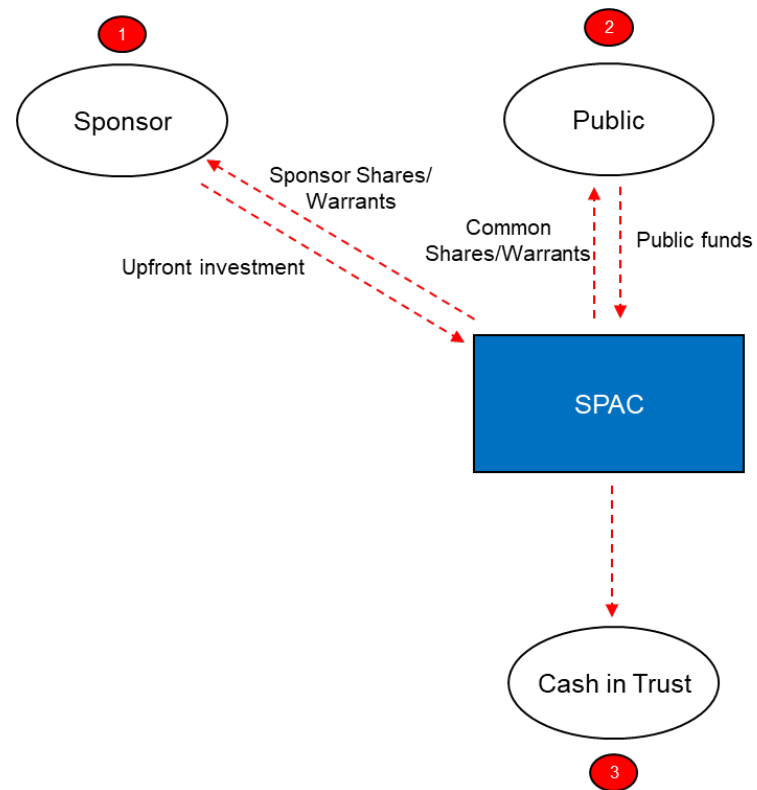
# SPAC Introduction

## Capital Structure

- **Additional Funds**
  - If additional cash is needed to finance a business combination (i.e., because IPO proceeds won't cover the price of the identified target), a SPAC may raise funds in a private issuance
    - Such private issuances often take the form of a "private investment in public equity" (a "PIPE")
- **Earnouts**
  - Earnouts have been used by SPACs in connection with business combinations in order to entice target sellers
  - Such earnouts may take the form of SPAC warrants exercisable upon a specified level of SPAC common share appreciation
    - There has been at least one known deal that involved a dual earnout whereby (i) Sponsors waived a portion of their Sponsor Promote in exchange for warrants and (ii) target sellers received warrants in addition to the deal consideration
  - Earnouts assist target rollover sellers (i.e. sellers receiving consideration for their target equity in the form of SPAC shares) in mitigating the dilutive effect of previously issued SPAC warrants

# SPAC Formation Issues

- Typical SPAC IPO Structure



# SPAC Formation Issues

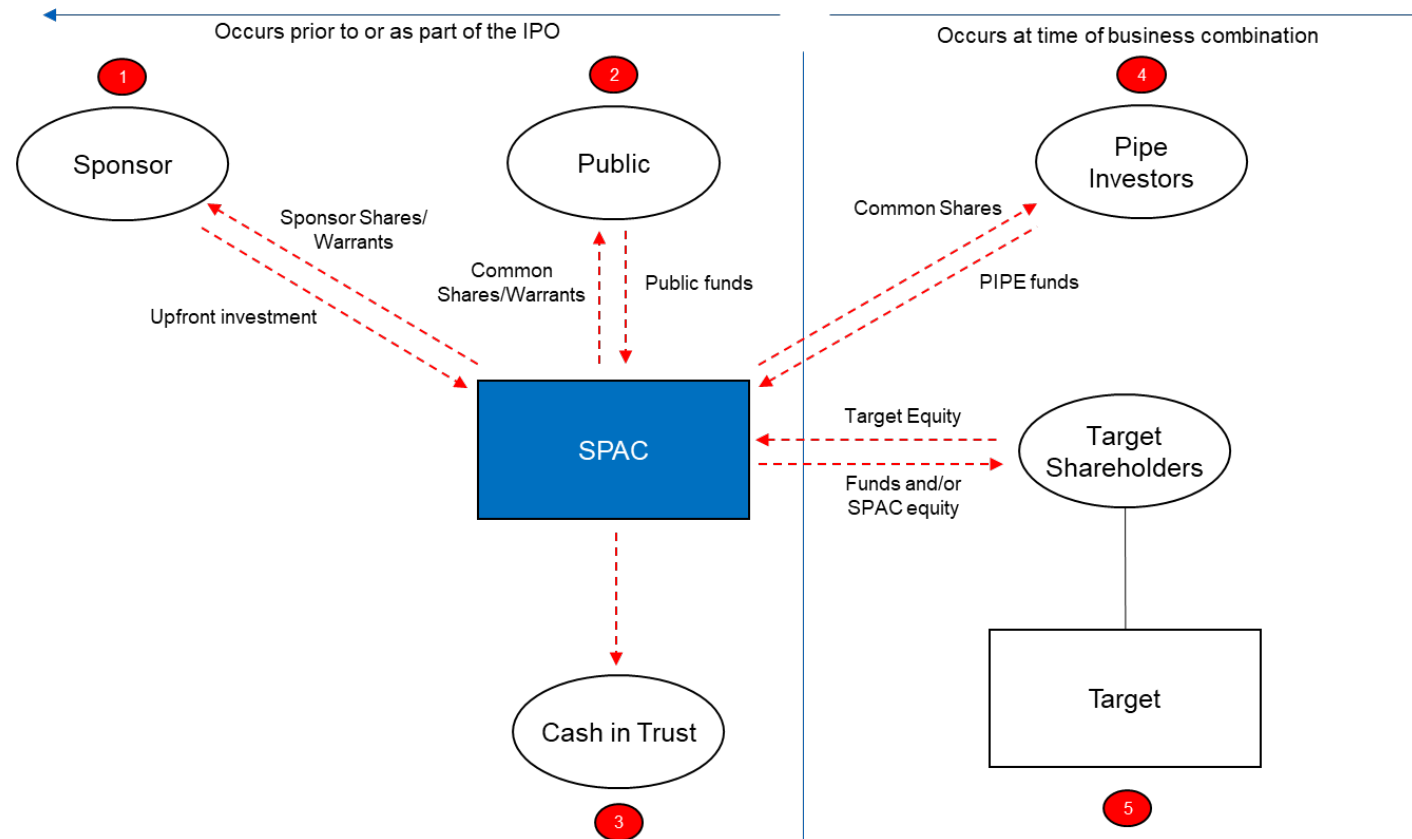
## Jurisdictional Considerations

- Sponsors in the market for targets based in the United States generally form a domestic SPAC (a “domestic-to-domestic” transaction)
- Sponsors in the market for foreign targets generally form a foreign SPAC (a “foreign-to-foreign” transaction)
  - Difficult tax issues can arise if, for whatever reason, a domestic SPAC identifies a foreign target or a foreign SPAC identifies a domestic target

Type of SPAC	Type of Acquisition Target	General Post-Acquisition Topco Structure
U.S. Corp	U.S. Corp	▪ U.S. Corporation
U.S. Corp	Foreign Corp	▪ Foreign Corporation ▪ Subject to complying / addressing U.S. anti-inversion rules
Foreign Corp	U.S. Corp	▪ U.S. Corporation
Foreign Corp	Foreign Entity / Business	▪ Foreign Corporation

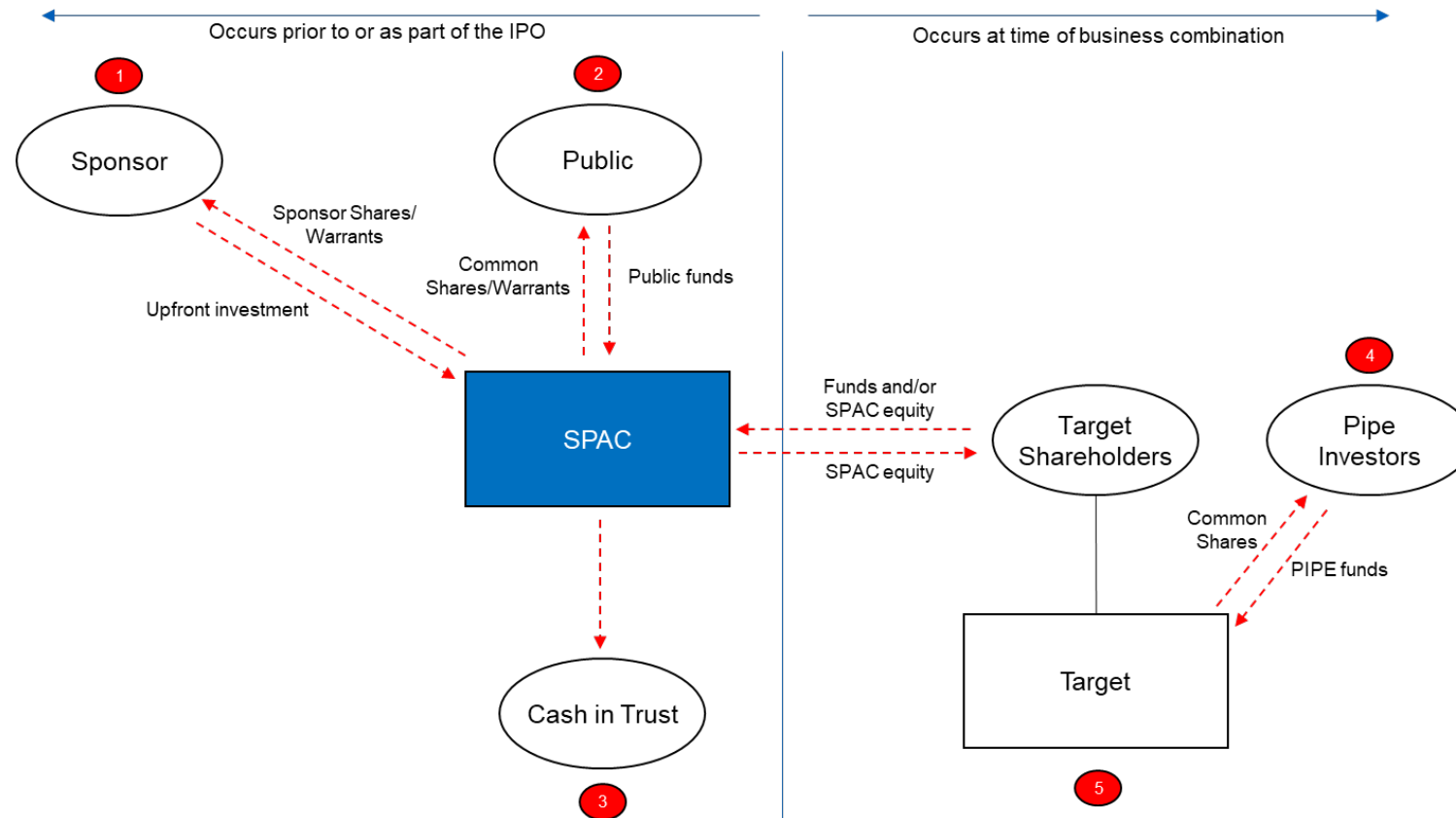
# De-SPAC Tax Structuring

## Typical SPAC Acquisition Structure



# De-SPAC Tax Structuring

## Typical SPAC Acquisition Structure



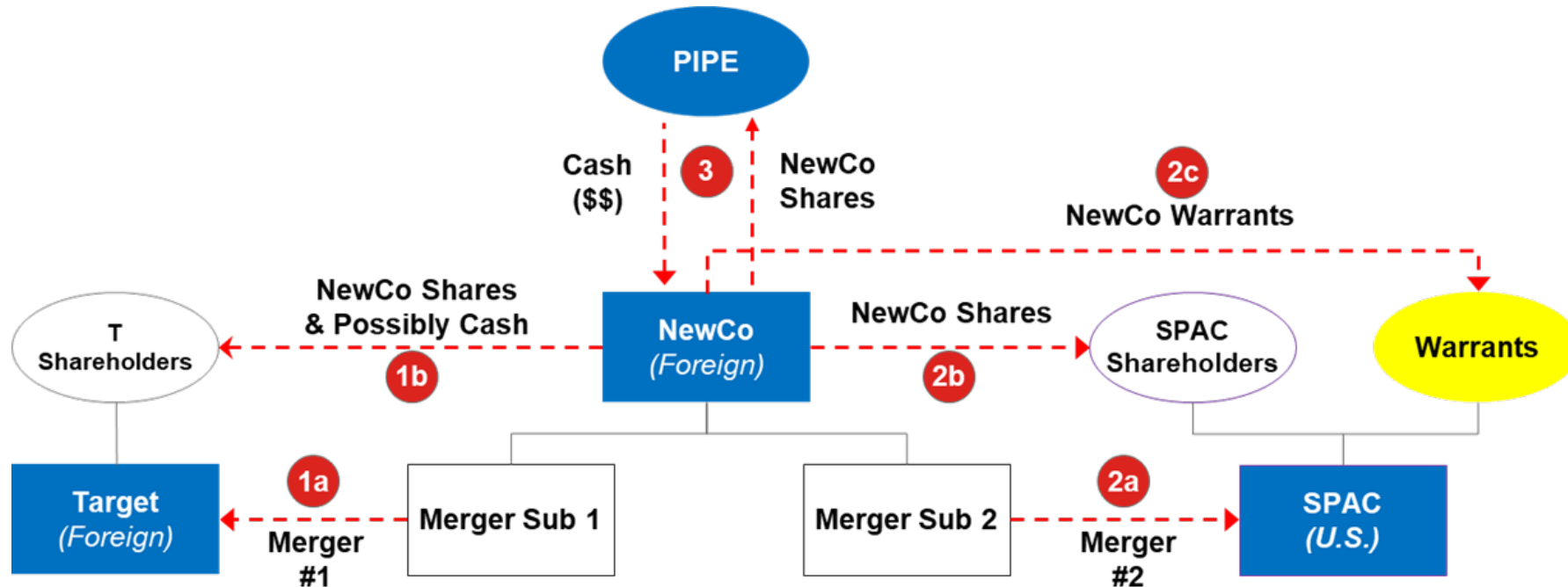
# De-SPAC Tax Structuring

## Domestic SPAC With A Foreign Target

- Sponsors seeking foreign targets typically set up foreign SPACs
- If a domestic SPAC happens to identify a foreign target, it would typically attempt to expatriate to the jurisdiction of the foreign target prior to the business combination
  - Note that simply maintaining a domestic SPAC operating the target as a foreign business would be tax-inefficient, as the foreign business would be a CFC (if organized as a corporation) or the SPAC would be subject to taxation in the foreign jurisdiction
- An expatriation transaction would typically be structured as a Horizontal Double Dummy transaction (treated as a section 351 capital contribution)

# De-SPAC Tax Structuring

Domestic SPAC With A Foreign Target – Horizontal Double Dummy Structure





# De-SPAC Tax Structuring

## Domestic SPAC With A Foreign Target – Horizontal Double Dummy Explained

- Transaction is intended to qualify as a valid Section 351 transaction
  - Section 351: Transfer of property to a corporation (here, NewCo) where the transferors, in the aggregate, receive stock representing (i)  $\geq 80\%$  of the voting stock and (ii)  $\geq 80\%$  of any class of nonvoting stock – clearly met here (“section 368(c) Control”)
  - No COBE issue; similarly, other reorganization requirements are not applicable
  - Ensures transaction will be tax-free to SPAC shareholders (subject to section 367)
- But, unlike in a reorganization, the receipt of warrants is not tax-free in a section 351 transaction
  - Relevant here because in the traditional double dummy, all of the depicted stakeholders are transferring property to NewCo, including SPAC’s warrant holders – warrant treatment can be especially important for Sponsor
- Section 351 qualification does not preclude taxpayer from making the argument that the SPAC merger (Merger #2) is a valid reorganization (if and when you conclude you will satisfy COBE and any other applicable requirements)

# De-SPAC Tax Structuring

## Domestic SPAC With A Foreign Target (cont'd)

- In addition to Section 367(a), expatriations in this context implicate the anti-inversion rules contained in Section 7874 and accompanying regulations, which may potentially be a “deal killer”
  - Under Section 7874, an “inversion” occurs where a foreign corporation acquires substantially all of a domestic business whose former owners own 60% or more (by vote or value) of the foreign acquiring corporation after the transaction by reason of their ownership in the domestic business
  - If former owners of the domestic business own 80% or more (by vote or value) of the foreign acquiring corporation, then the foreign corporation is treated as domestic for all US tax purposes
    - 60% and 80% tests are referred to herein as the “Ownership Tests”
    - Must follow special anti-inversion rules when calculating Ownership Tests, which can result in “tax” ownership that differs from actual ownership
  - “Substantial business activities” exception may apply to except SPAC expatriation from Section 7874
  - New potential challenges are in the horizon, with changes to the inversion rules proposed by the Biden Administration including:
    - Lower ownership test percentages; and
    - a place of management and control new test.

# De-SPAC Tax Structuring

## Foreign SPAC With A Foreign Target

- Since most SPACs have US persons as shareholders, there are many US tax considerations
- Passive Foreign Investment Company Considerations
  - Whether the SPAC will qualify depends on meeting certain exceptions.
- Majority of non-US SPACs have been typically incorporated in the Cayman Islands or the British Virgin Islands. Immediately prior to a business combination, a foreign SPAC will typically migrate to the jurisdiction of its identified target
  - Migration transactions typically take the form of an F reorganization
  - Implicates the foreign-to-foreign reorganization rules in Section 367(b)
- If the foreign target has US holders, they may desire to structure the business combination as a tax-free reorganization transaction
  - Implicates the potential gain recognition rules in Section 367(a)

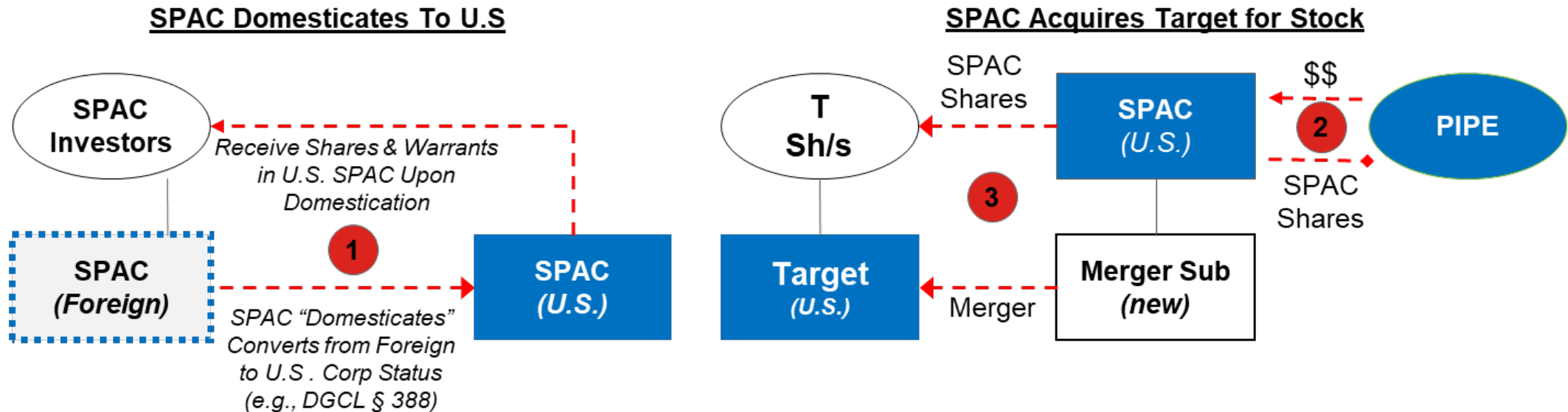
# De-SPAC Tax Structuring

## Foreign SPAC With A Domestic Target

- Sponsors seeking domestic targets typically set up domestic SPACs
- If a foreign SPAC happens to identify a domestic target, it would typically attempt to migrate from the foreign jurisdiction to the United States in an inbound F reorganization prior to the business combination (a “domestication”)
  - The foreign SPAC would be treated as transferring all of its assets to a newly-formed domestic SPAC in exchange for domestic SPAC stock, which foreign SPAC distributes to its shareholders in complete liquidation. Foreign SPAC holders would be treated as exchanging their foreign SPAC equity for domestic SPAC equity.
- Section 367(b) may apply upon a domestication
- PFIC rules, including regulations proposed under Section 1291(f), may apply upon a domestication

# De-SPAC Tax Structuring

## Foreign SPAC With A Domestic Target – Domestication Structure



# De-SPAC Tax Structuring

## Foreign SPAC With A Domestic Target – Domestication Explained

- Domestication: SPAC converts from being a foreign corporation (e.g., Cayman Islands) to a U.S. corporation (e.g., Delaware)
  - Domestication is a simple and routine paperwork process – readily handled by counsel (DGCL § 388)
  - Domestication qualifies as a “F” reorganization – SPAC’s shares and warrants simply transform into shares and warrants in the now domesticated U.S. SPAC – no change in economic or other terms
  - Practically speaking, domestication is tax-free to shareholders since shareholders only need to include his/her share of SPAC’s “all earnings and profits amount,” which should be \$0 (or virtually \$0) since SPAC will have had no income or (virtually no) income as of the time of domestication (Reg. §1.367(b)-3(c)(2))
    - ≤10% Shareholder need to make election to include All E&P amount; otherwise must recognize lesser of gain realized or All E&P amount
  - Typically shareholders should make a QEF election to protect themselves in the event the SPAC is classified as a “passive foreign investment company” (“PFIC”) – avoids having to pick up any extra income on domestication beyond the All E&P amount
  - Taxation of SPAC warrants not clear under the PFIC rules (if they apply)
- Acquisition/Combination: SPAC’s acquisition of Target stock generally intended to qualify as a tax-free reorganization

# SPACs in Latin America

## Brazilian Transactions

- Boulevard Acquisition Corp. II's acquisition of Estre Ambiental S.A.
  - Cayman SPAC with Brazilian target (waste management)
  - Business combination
    - Estre ("Target") and Newco (a Cayman Islands public entity) completed the Pre-Closing Restructuring pursuant to which, immediately prior to effecting the Merger, the holders of Target Shares converted their Target Shares into Ordinary Shares, and Target, as a result, became a wholly-owned indirect subsidiary of Newco
    - The business combination agreement provided for Merger Sub merging with and into Boulevard, with Boulevard surviving as a partially owned subsidiary of Newco
  - Economics – each unit consists of a Class A common share with one whole warrant.

# SPACs in Latin America

## Brazilian Transactions (cont'd)

- GP Investments Acquisition Corp. (SPAC of GP Investments Ltd., Brazilian private equity firm) acquisition of World Kitchen, LLC.
  - Foreign SPAC with domestic target
  - Domestication proposal – as a condition to the closing of the business combination, GP Investments Acquisition Corp. (“SPAC”) migrated from Cayman Islands and incorporated in Delaware and changed its name to World Kitchen Group, Inc. (“WDKN”)
    - On domestication, shares of SPAC were automatically converted on a one-for-one basis to common stock of WDKN
  - Business combination – Merger Sub, a wholly owned subsidiary of WDKN merged with and into Target, with Target surviving.
    - Each unit consists of one Class A common share and one half of one warrant



# SPACs in Latin America

## Colombian Transactions

- Union Acquisition Corp. II's business combination agreement with Procaps Group
  - Cayman Island SPAC
    - IPO completed on October 22, 2019 on the NASDAQ Stock Exchange
    - Proceeds of USD 200 million upon consummation of the IPO
  - Colombian Target
    - Colombian family-owned Company established over 40 years ago
    - Gross revenue in 2020 of USD 380 million, 5,000+ employees, 13 countries
  - Business combination
    - On March 31, 2021, UAC II announced a definitive business combination agreement along with a fully committed and oversubscribed PIPE financing agreement with Procaps Group
    - Transaction expected to close in the third quarter of 2021

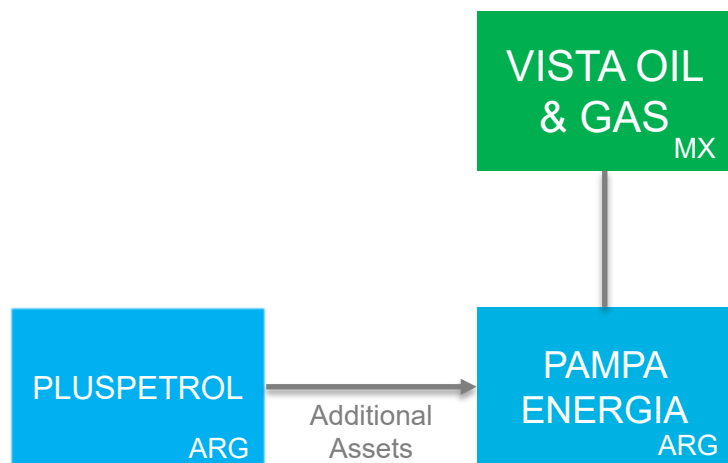
Source: <https://unionacquisitiongroup.com/uac-ii/>

# SPACs in Latin America

## Mexican Transaction

- Vista Oil & Gas, S.A.B. de C.V. acquisition of Argentinian entities Pampa Energía S.A. and Pluspetrol Resources Corporation
- DD3 Acquisition Corp acquisition of Betterware de México
- Promecap Acquisition Company (PAC) acquisition through a domestic merger of Valores Integrales Inmobiliarios, S.A. (VIISA)

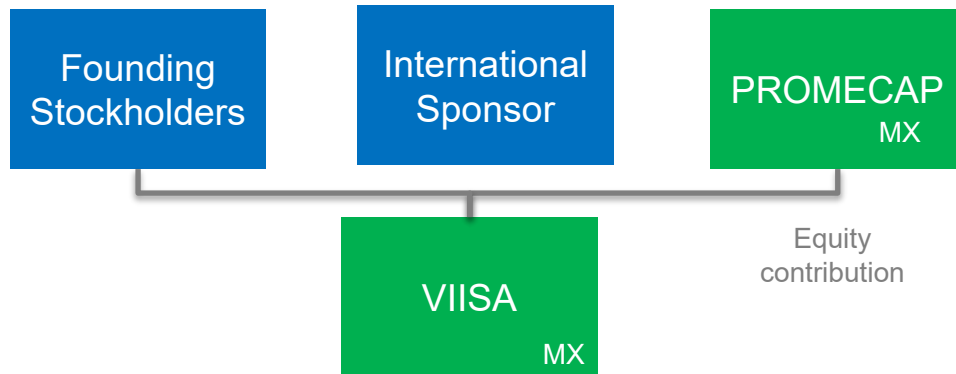
# MEXICO: Cross Border De-SPAC



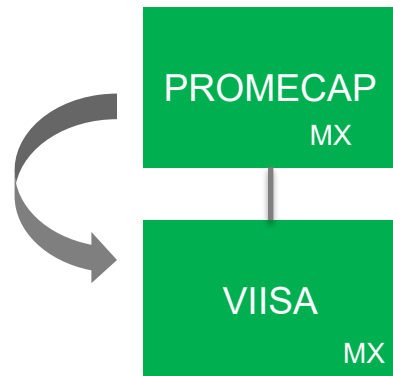
- Initial business combination was conducted by having Vista Oil & Gas buying stock of Pampa Energia in Argentina.
- New subsidiary also purchased from Pluspetrol Resources Corporation additional assets located therein.

# MEXICO: Local De-SPAC

(STEP 1)



(STEP 2)



- De-SPAC was accomplished by Promecap contributing equity to VIISA (diluted basis).
- Following a listing of VIISA stocks in Mexican Exchange, Promecap was downstream merged into VIISA, the latter as surviving entity.
- Initial investors in Promecap SPAC became VIISA stockholders.
- Founding Stockholders and International Sponsors

# PE in Latin America

- **Analysis of recent approach of private equity**
  - Main structures in Brazil, Mexico and Colombia
  - Comments from US perspective

# BRAZIL: Recent Investment Structures

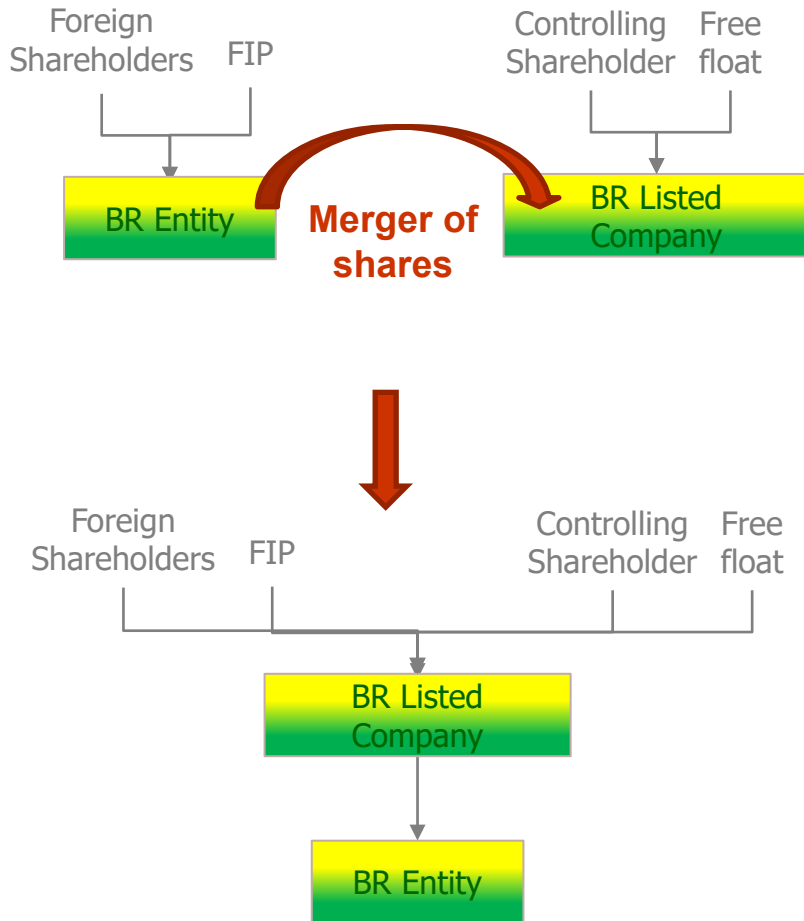
- **Choice of investment structure**
  - Recent transactions in Brazil have analyzed the potential exit investment alternatives in order to define the structure for the transactions
- **Exit in Brazil**
  - Direct investment x use of private equity investment funds (FIP)
  - Consolidation cases: merger of shares
- **Exit outside Brazil**
  - Offshore investment vehicle looking for indirect sale or public offering outside Brazil

# BRAZIL: Local Traditional Structures for Private Equity

	Direct Investment	FIP – No Exemption	FIP – Exemption
Tax burden for dividends	0%	15%	0%
Tax burden for capital gain on sale of Target	15% to 22.5%	15%	0%

- Structures focused on exit in Brazil
- Recent discussions and assessments about the exemption for FIP investors
  - Exemption: non taxation for investors with less than 40%
  - Discussion of related parties and the roll of the general manager
  - Questioning of indirect Brazilian resident and indirect tax haven investor
- Review of FIP structures
- Discussion with service providers

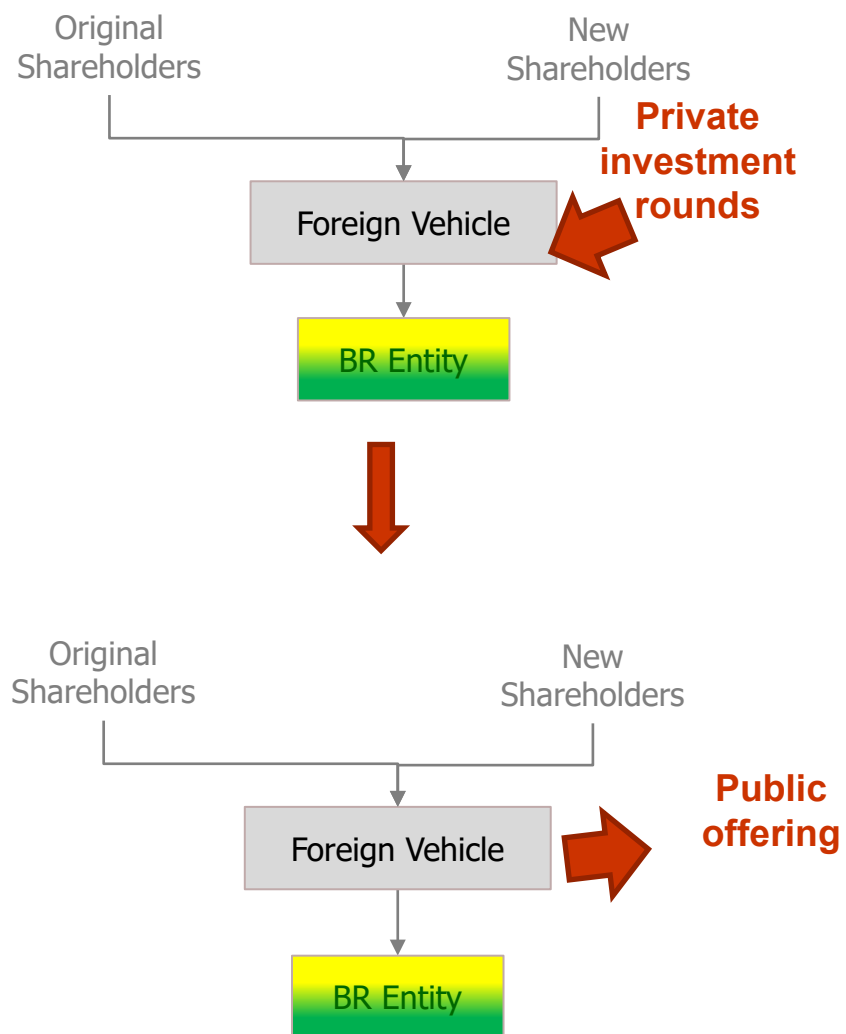
# BRAZIL: Example of Consolidation and Business Combination



- **Capital gain in Brazil**
  - Discussion of income tax for shareholders of the BR Entity
  - “Disposal” of BR Entity shares
  - Responsibility for BR Listed Company regarding capital gain of shareholders of BR Entity domiciled outside Brazil
- **Example:** Carrefour / Walmart / Grupo BIG deal
- **Considerations in Mexico and Colombia**
  - Is there any similar transaction in Mexico and Colombia? Discussion of capital gain?
- **Considerations in US**
  - Implications for US investors in a merger of shares

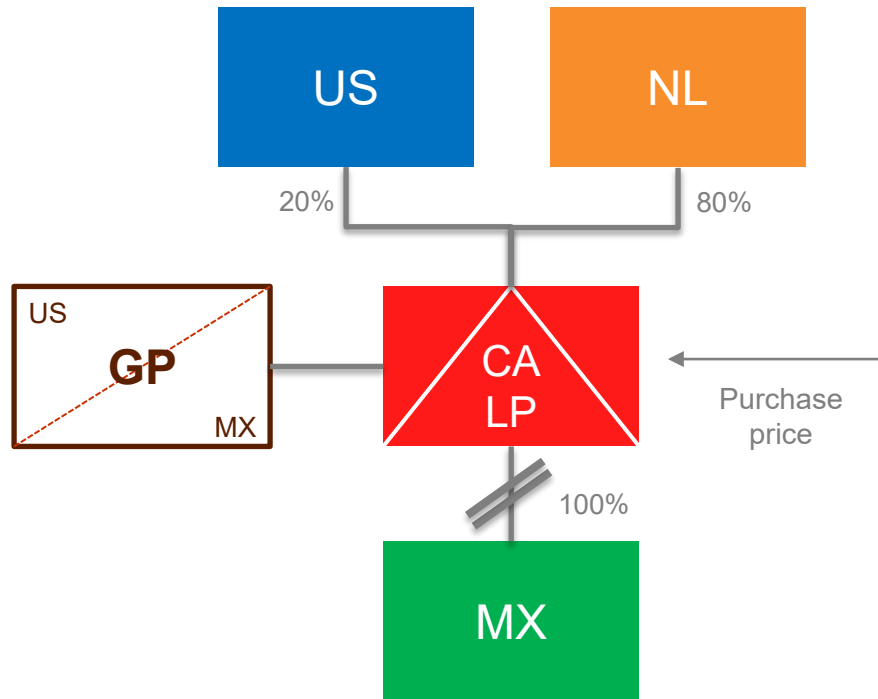


# BRAZIL: Example of Public Offering Outside Brazil



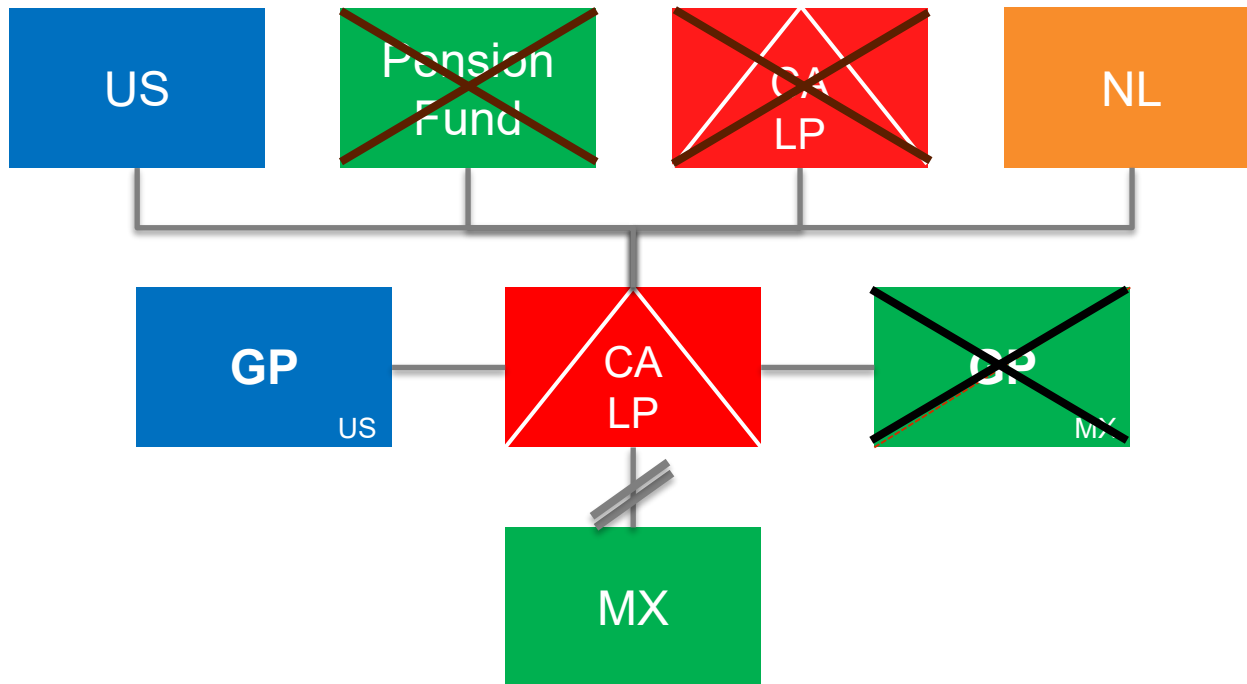
- **Capital gain in Brazil**
  - No taxation in Brazil: sale of shares of the foreign vehicle
  - Discussion of indirect sale of BR Entity
- **Example**
  - Stone
- **Considerations in Mexico and Colombia**
  - Is there any similar transaction in Mexico and Colombia?
  - Discussion of capital gain?
- **Considerations in US**

# MEXICO: PE Transactions



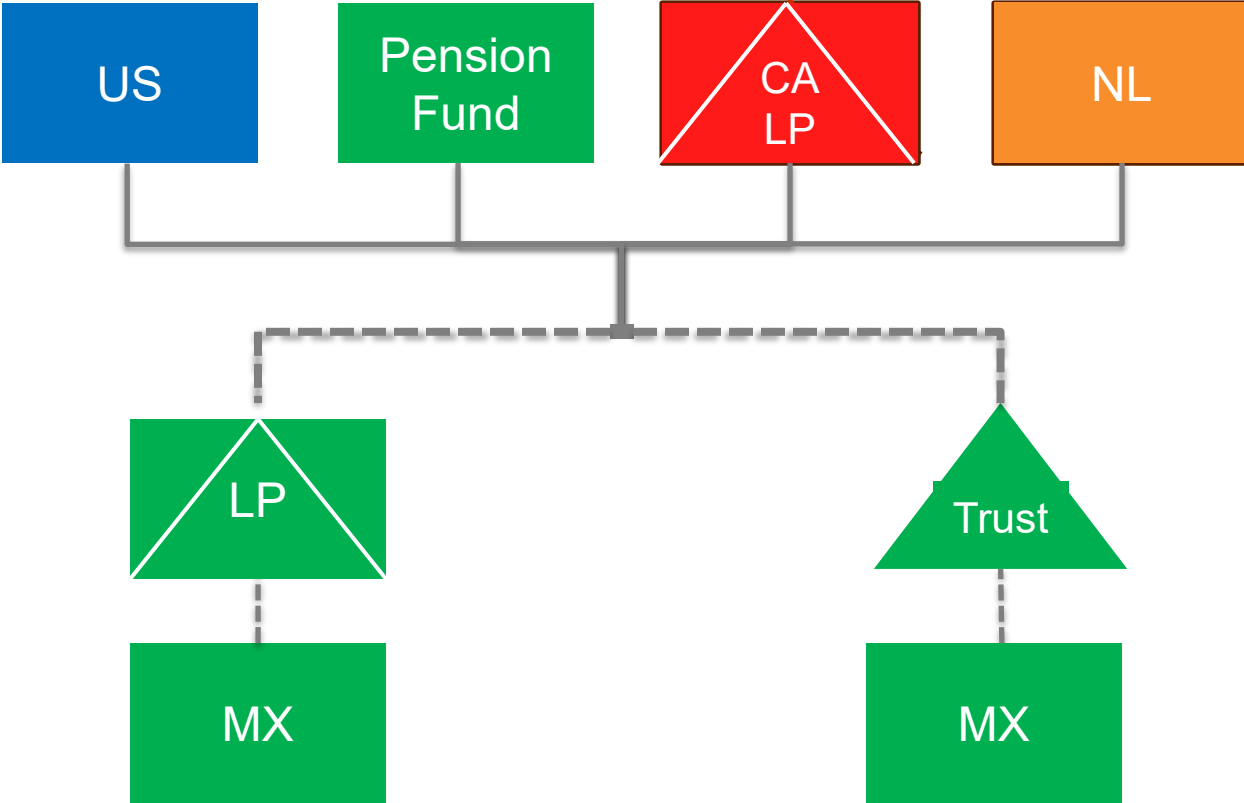
- Traditionally investments in Mexico were conducted through Canadian LPs
- Tax transparency for LPs allowed NL to pay 10% on the capital gain and US to be exempt (treaty benefits).
- 2021 Tax Reform eliminated tax transparency status for foreign vehicles.
- The practical effect is that transactions would be subject to 25% tax on gross proceeds payable by CA LP.
- Only certain treaties would remain applicable (e.g., US).

# MEXICO: Tax Incentive (Article 205)



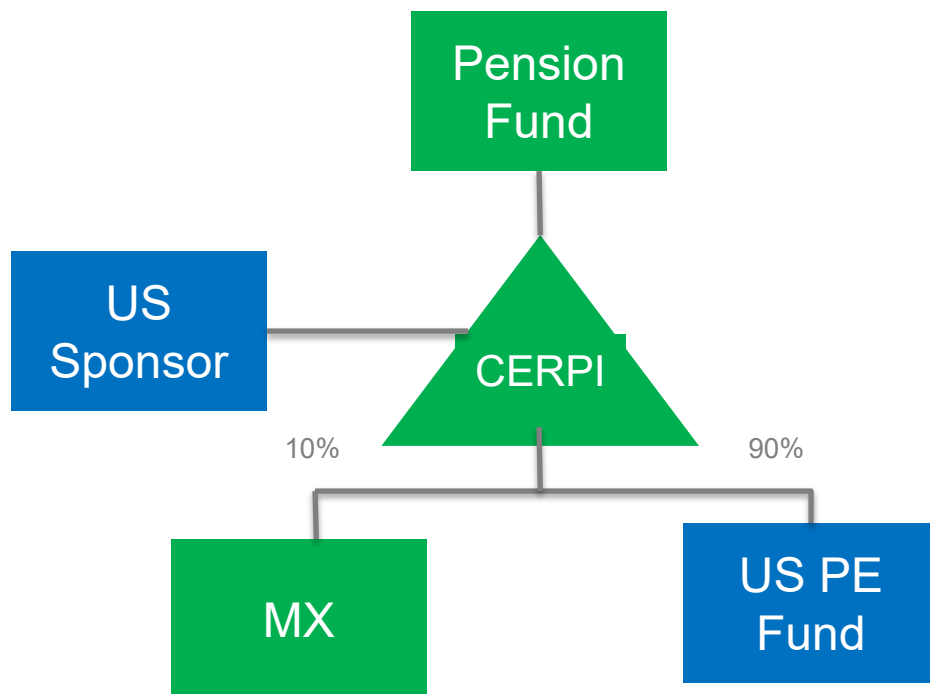
- US would remain exempt under tax treaty and MAP.
- Pension Fund and CA LP won't be exempt.
- NL would be able to claim for treaty benefits and apply 10% rate on capital gains (subject to discussions with tax authority)
- The fund requires to be managed from abroad.
- Several tax compliance requirements.

# MEXICO: Domestic Fund Formation Alternatives



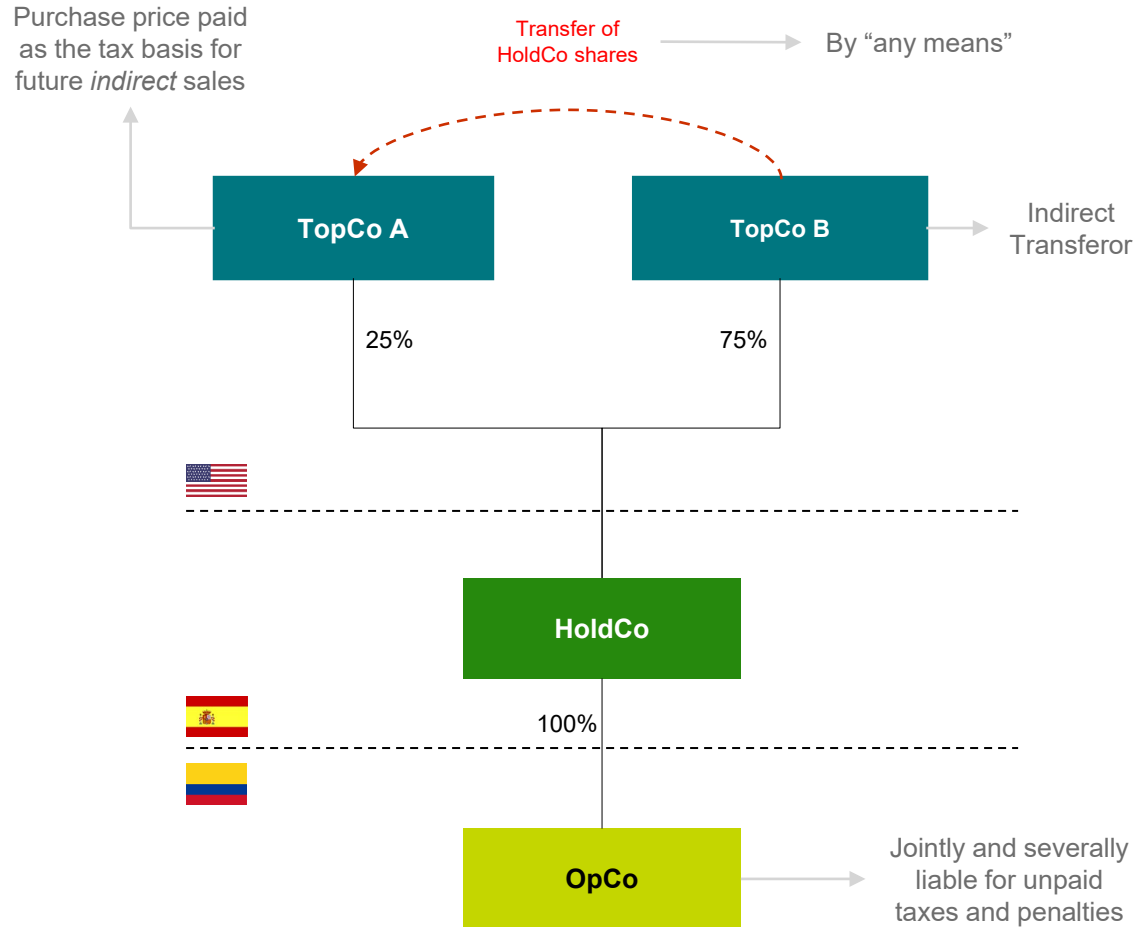
- Mexican LP (“*Asociación en Participación*”) and Trust (“*Fideicomiso*”) remain transparent under domestic tax laws.
- Participants would maintain transparent capital gains tax treatment and would be entitled to claim for treaty benefits.

# MEXICO: Publicly Traded PE



- Mexican Pension Funds are entitled to invest in foreign PE only if investment is conducted through a Mexican CERPI.
- CERPI is a Mexican Trust that issues certificates in the Mexican Stock Exchange.
- Requirement for the CERPI to invest 10% of its funds in Mexican assets.

# COLOMBIA: Offshore Indirect Transfers Regime



## Transaction Considerations

- **Investment**

- Possible transfer of seller tax liabilities
  - CGT rate 10% or 31% depending on the holding period
  - SPA protection

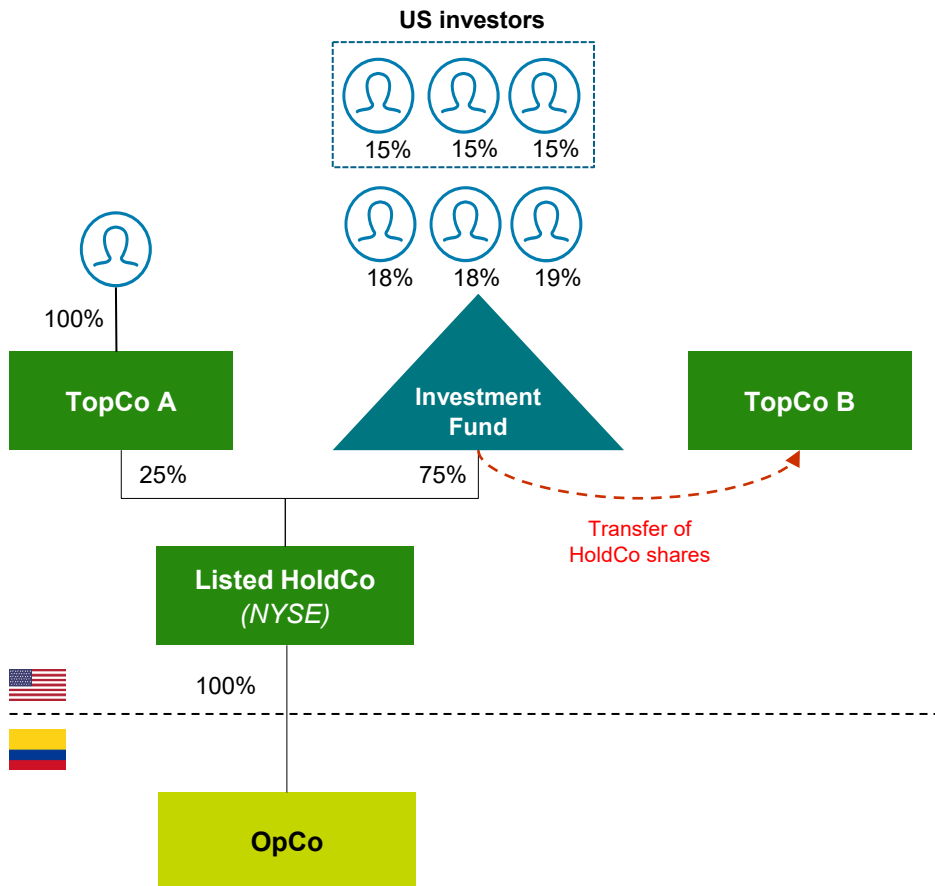
- **Project life**

- Effect of potential reorganizations
  - Structure planning

- **Exit**

- Tax basis determination
  - Purchase price / inherited tax basis
- Capital Gains Tax
  - Structure planning (DTTs)

# COLOMBIA: Offshore Indirect Transfers Regime in PE Structures



## Public share exception

- Colombian indirect transfer regimen does not apply to the transfer of shares listed on a recognized stock exchange, when the shares are not held by the same *real beneficiary* in more than 20%.

## Case facts

- The US investors manage their stakes through the Investment Fund.
- The Investment Fund invests in HoldCo shares (listed in the NYSE), which has underlying Colombian assets (OpCo's shares).
- The Investment Fund sells HoldCo's shares to a third party.

## Questions

- Does the public share exception apply in this case?
- Is the transfer taxed for the minority US investors?
- Who is the indirect transferor?