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Statutory & regulatory amendments in India to make SPACs effective

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The concept of Special Purpose Acquisition Companies (**SPACs**) was introduced to promote innovative methods for raising capital. SPACs have existed for decades and have descended from mere 'blank-check corporations' to being one of the hottest trends at Wall Street. The New York Stock Exchange (**NYSE**) launched its first SPAC in May 2017 and subsequently, SPAC transactions have escalated drastically with the U.S SPACs raising more than a record USD 83.4 billion in the initial three months of 2021.

SPACs are referred to as 'blank check' entities because they go public for fundraising and listing even before the acquisition target is identified. They are essentially shell companies, having no underlying business except for the sole purpose of raising public funds through an IPO and thereafter acquiring an unidentified target company out of these funds, within a stipulated timeframe.

In India, where emerging companies require appropriate funding, there are no precise and detailed regulations in place concerning SPAC's, barring the IFSCA (Issuance and Listing of Securities) Regulations, 2021 (**IFSCA Regulation**), as discussed below, where too the existing laws require amendments. Nevertheless, Indian Companies have opted this route in the past. To quote a few examples, way back in 2016, Yatra Online Inc. was acquired by Terrapin 3 Acquisition Corp via reverse merger and the deal valued one of the top three OTAs at USD 218 Million in India. Likewise, Videocon DTH was listed on the NASDAQ through a reverse merger with Silver Eagle Acquisition Corp with a deal value of around USD 375 Million.

Although SEBI seeks to examine the feasibility of SPACs in India and has formed an expert group to examine the same in March 2021, it is yet to draft a specific framework for regulating these entities. The International Financial Services Centre Authority (**IFSCA**) had released the IFSCA Regulations specifying the regulatory provisions on the issuance and listing of securities on the IFSC's recognized stock exchanges. In September 2020, the Indian Government approved the direct listing of Indian companies on overseas stock exchanges. Further, Section 23 of the Indian Companies Act, 2013 (**Companies Act**), had been amended[1] to create an enabling provision for such listing in certain permitted jurisdictions. This release facilitates issuer's access to global capital. Robust valuation and excess SPAC vehicles do indicate an upward graph of De-SPACs in India but, the regulatory and tax challenges create a hurdle.

[1] https://www.mca.gov.in/Ministry/pdf/AmendmentAct_29092020.pdf

Existing legal framework for companies in India which would primarily impact SPACs

- **Companies Act, 2013:** As per Section 248 of the Companies Act, the Registrar of Companies (RoC) has the power to remove a company's name from the register of companies if it has 'failed to commence its business within one year of its incorporation.'

  In case of SPACs, the typical acquisition timeline is around 18 months or more. This clause in the Act presents a major hurdle for SPAC implementation in India. Therefore, either fresh provisions may be inserted, or existing provisions may be tweaked to enable SPAC employment in the country.

  In the recent years, MCA has removed the names of several companies from the official records following the 'Special Drive for identification and strike off Shell Companies' where more than 3.82 lakh companies were struck off the RoCs in the past. three years for failing to submit their annual returns for two years or more. The current mindset of the regulators must be changed to accommodate SPAC transactions as the acquisition timeline for SPAC transaction is more than 18 months during which time the company remains a shell company.
- **SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018:** According to Regulation 6(1) of the ICDR Regulations 2018, a company should have had minimum INR 3 crore net tangible assets for the preceding three years, and an average operating profit of at least INR 15 crore during the preceding three years and a net worth of at least INR 1 crore in each of the preceding three years to be eligible to proceed with an IPO.

  Nonetheless, SPACs are fundamentally shell companies till the De-SPAC process is completed and this provision is unquestionably a stumbling block for these blank check companies to being floated on any recognized Stock Exchange and necessitates amendment clause for SPAC entities alone.
- **Stamp Duty:** The legislation regarding Stamp Duty levy in cases of mergers is not uniform in India and the payment of Stamp Duty varies from one jurisdiction to another. The Apex Court has reiterated the same in the Hindustan Lever case by holding that a scheme effecting mergers is an instrument and the order of a court or tribunal sanctioning the merger is subject to stamp duty levy2. A typical De-SPAC process from the Indian laws standpoint is a reverse merger, subject to high Stamp Duty levy which makes the business combination unappealing in the current scenario.
- **Exchange control concerns:** During the De-SPAC process, the investors and shareholders of the target entities receive shares of the combined SPAC entity. Under the Foreign Exchange Management Act, 1999 and its subsequent rules, the resident individuals and shareholders are allowed to remit freely up to USD 250,000 per financial year. Based on forex reserves and macro-economic parameters, RBI varies the aforesaid limit from time to time. In essence, the RBI necessitates that the fair market value of the shares falls within the limits prescribed under the Liberalized Scheme. This cap on the shareholders acquisition of shares might be an obstacle in a scenario where the fair market acquisition of a De-SPAC is likely to exceed the RBI limit. Therefore, it is crucial to either widen the prevailing threshold or exempt these transactions from Liberalized Remittance Scheme.

Conclusion

The objectives of SPACs are to de-risk and shorten the IPO process, overcome the legal impediments, and realize the immense potential of start-ups by raising funds and generating liquidity. In this regard, the IFSCA has released a draft framework to enable listing of SPACs on the IFSCs recognized stock exchanges. While these regulations are indeed a step forward, they lack a concrete regulatory structure and limiting SPACs listings to IFSCs will deter the pace of SPAC growth in India. Thus, it is germane to revise the existing statutory framework to accommodate SPAC mergers or draft a separate framework, specifically for SPAC. The existing legislative norms need to be amended and made more flexible to accommodate the growth of SPACs in India and in this direction, SEBI should restructure the regulations and provide an impulse to the start-up ecosystem in the country.

[2] *Hindustan Lever & Anr v. State of Maharashtra & Anr*; (2004) 9 SCC 438.