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CONUNDRUM IN THE DEVELOPMENT OF SPECIAL PURPOSE ACQUISITION COMPANIES (SPAC) IN THE INDIAN CORPORATE SECTOR

ABSTRACT[1]

SPACs (Special Purpose Acquisition Companies) have been gaining prominence in the worldwide capital markets environment during the last few years. SPACs have been around for a long time, but the current increase in SPACs in the markets, particularly in the United States of America, has been phenomenal. Since the renewable energy company ReNew Power adopted the SPAC approach to get listed on the Nasdaq exchange, SPACs have been a big subject in India.[2] A special purpose acquisition company (SPAC) is a corporation created to raise capital through an initial public offering (IPO). These are often known as "blank check" businesses. A SPAC starts as a shell company, with the proceeds from the IPO going into a trust fund account until the target operational firm is found. Following the identification of the target business, the SPAC's shareholders are asked for their approval, and those who do not wish to sell their interests are offered the chance to redeem them. Finally, the de-SPAC step commences, which involves the completion of the acquisition transaction. The SPAC system in India is once again in the discussion, particularly following ReNew Power's merger with RMG Acquisition Corporation II, a US-based SPAC. Companies like Grofers, Flipkart, Videocon D2H, and the travel firm Yatra have invested in or are considering investing in US-based SPACs, including multi-million-dollar purchases. SPACs are commonly utilized by start-ups to get easy access to the stock market. Given these conditions, India will soon revise its SPAC rules and GoPro SPAC, which is now not the case in the country.

[1] Ayush Patria, Sangam University, Bhilwara [Rajasthan]

[2]. Rakesh Nangia and Neha Malhotra, *Regulatory challenges for SPACs in India*, The Hindu Business Line (Jun. 26, 2021, 10:58AM), https://www.thehindubusinessline.com/business-laws/regulatory-challenges-for-spacs-in-india/article34124252.ece

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I. WHAT ARE SPECIAL PURPOSE ACQUISITION COMPANIES (SPACS)?

SPACs are corporations created to bring in revenue through an IPO to utilize the proceeds to buy one or more firms selected after the IPO. SPACs are shell companies that attempt to acquire funds from investors to purchase and merge with up-and-coming private companies. SPACs, also known as Blank Cheque Companies, are corporations created only to acquire another corporation and have no other business activity.[3] The SPAC, which is made up of a group of professional institutional investors, is tasked with identifying a target within a two-year time frame and investing the IPO proceeds there, subject to shareholder approval. Otherwise, the SPAC IPO profits are returned to investors with interest.

They employ a strategy that may be described as a reverse merger, in which they raise money and then search for firms to combine within the hopes of finding a pot of gold at the end. These businesses do not follow the typical business model and do not engage in any commercial activities that a business would normally engage in, such as the production of products or services. The only asset these firms have, according to the Securities and Exchange Commission, is the money raised in their first public offering.[4]

When the deal gets done, the SPACs will reflect the target company's identity. As a result, the unlisted target is immediately added to the list. SPACs have emerged as potential possibilities for start-ups in India that find it difficult to meet the criteria for listing through an IPO because they allow a private business to become public and get money more rapidly than it would with the traditional IPO route.[5]

While SPACs have been around for a while, their tremendous rise has lately been seen as a result of market volatility caused by the epidemic. While several firms postponed their IPO due to concerns about the failure of the public offering, others decided to merge with a SPAC as an alternative.

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[3]. *Ibid.*

[4]. Mugeera Patel, All you need to know about the rising Special Purpose Acquisition Companies (SPAC), iPleaders (June 26, 2021, 11:04AM), https://blog.ipleaders.in/need-know-rising-special-purpose-acquisition-companies-spac/

[5]. supra note 1.

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II. HOW DO SPECIAL PURPOSE ACQUISITION COMPANIES WORK?

New-age entrepreneurs are recognized for creating innovative processes and systems, and the cornerstone of a SPAC firm essentially begins with a unique concept or market narrative that such entrepreneurs can sell to investors. Then, using form S-1 under the Securities Act of 1993, this group of entrepreneurs and investors will submit a statement of registration with the Securities and Exchange Commission (SEC). This form requires the firm to declare the type of security it plans to sell, the total number of shares and the price per share, as well as any corporate property. Accountants must sign off on these disclosures and evaluate them.

The SPAC must develop necessary underwriting agreements (agreements with investment banks or financing institutions) that contain a trust account setting agreement while this procedure is continuing. The money raised from the IPOs is held in this trust. The SEC participates actively in the process by performing thorough due diligence on the firm and issuing a clearance based on the papers and disclosures provided. Following this approval, the management of these firms can begin attending exhibits, roadshows, conferences, and other events where they can effectively promote their businesses. The main distinction is that senior management personnel brought in by the sponsor sell their knowledge in the industry in which the SPAC is to be operated, rather than a specific firm. This creates a buzz in the market, which aids them in gaining attention and raising further funds. Following that, they begin issuing common stock for $10 per share, which is the usual base price for most SPAC shares, according to the SEC.[6]

If the SPAC succeeds in striking a chord with people and investors as a result of the management's efforts before the share offerings, the funds from such investments are held in trust until the newly formed SPAC business decides and finds a company to purchase. One of two things can happen during this time: if the purchase proves to be successful, the value of the trust's shares grows, and investors become interested in it; if the acquisition does not go as planned, the share's base price remains at the amount paid by an investor. Furthermore, if the SPAC business is unable to locate a suitable organization for merging within two years, they must dissolve and return the initial investment plus interest to the stockholders.[7]

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[6]. *Ibid.*

[7]. *Supra* note 3

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III. MERITS OF RISING SPECIAL PURPOSE ACQUISITION COMPANIES

- *The difference in timelines:* The time it takes to go public in the domestic market might range from four months to a year. These timescales are believed to be limited by SPAC businesses, ranging from 4-6 months. Furthermore, in conventional IPOs and merges, explicit covenants in the contract and merger scheme limit anything that is not in keeping with the normal course of business. This sort of organization has yet to be seen in SPAC firms, allowing for more flexibility.[8]
- *Wider Access to Markets:* The firm would have been listed on the local exchange market in a typical IPO, but in the case of SPAC, it is listed on the US exchange market, providing it a better footing to attract investors.
- *Documentation:* One of the most important aspects to consider, especially for early-stage start-ups, is the cost of paperwork and disclosure. In SPAC firms, this expense is minimized to a minimum or none at all. Because the disclosure standards are less stringent than the rigorous screening procedure used by IPOs in general.
- *Reduced Market Risk:* The sponsor/main investor, not the financing institutions, decide and negotiates the worth of the firm to be bought. This results in pricing certainty rather than frequent market value changes.
- *Tax:* Certain tax obligations are seen as murky areas in domestic settings, increasing the burden on stakeholders. To reduce such obligations, enhance access to overseas finance and reap the benefits of tax-related preferential status for their company. Flipkart, for example, is registered in Singapore to take advantage of such a tax environment. Further expanding tech-based businesses, such as Cure Fit, have taken advantage of this by registering in other countries.[9]

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IV. DEMERITS OF RISING SPECIAL PURPOSE ACQUISITION COMPANIES

- *Blind investment:* Major owners in such a deal are essentially making a blind investment, as the risk is reduced but not eliminated. The sponsor who wanted to create the SPAC firm

[8]. *supra* note 3

[9]. *supra* note 1

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may discover that they are unable to do so, and the money will remain in place for the next two years, when they may be put to better use.

- *The Shell notion grey area:* SPAC is now viewed as a substitute for shell companies; nevertheless, this analogy is not widely accepted in many foreign marketplaces, and there is always an air of suspicion associated with this form of business. Companies in the IT industry may not want to deal with this since they are already dealing with many regulatory concerns such as GDPR, data sharing, and data protection, and adding this to the mix would raise their liability.[10]

V. REGULATORY FRAMEWORK ON SPECIAL PURPOSE ACQUISITION COMPANIES IN INDIA

The lack of specific SPAC legislation in India is a serious regulatory flaw. The regulations for SPAC are as follows:

- *Companies Act* - Since November 2016, when the government declared demonetization, shell firms have been under the government's control. In 2018, a Parliamentary Committee requested that the government give a clear definition for the term 'shell corporation' to eliminate any legal uncertainty and needless litigation. SPAC deals typically take 18-24 months to complete. However, under Section 248 of the Companies Act 2013, if a company fails to begin commercial activities within 12 months of its creation, the Registrar of Companies has the authority to remove the firm's name from the register.[11] This would create a slew of legal difficulties for the corporation's directors and promoters. However, this problem can be easily avoided by revisiting the regulations and amending the Companies Act to provide exemptions to SPACs if the purpose of their registration has already been made clear to the Registrar of Companies, removing any ambiguity that may arise as a result of the SPAC's business operations not being able to begin within one year of its incorporation.[12]
- *SEBI Regulations* - Even the Securities and Exchange Board of India Act does not recognize SPAC. A company must have net tangible assets of at least 3 crores rupees in the previous

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[10]. *supra* note 1

[11]. Karan Upadhyaya, *SPAC Regulations in India: Identifying regulatory challenges and the way forward*, SSC ONLINE (June 26, 2021, 11:47AM), https://www.scconline.com/blog/post/2021/06/08/spac-regulations-in-india/

[12]. *Regulatory Framework for SPAC in India*, Amlegals (Jun 26, 2021, 11:27AM), https://amlegals.com/regulatory-framework-for-spac-in-india/#

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three years, minimum average consolidated pre-tax operating profits of 15 crores rupees in any three of the previous five years, and net worth of at least 1 crore in each of the previous three years to be eligible for public listing.[13]

SPAC will be unable to make an IPO in India due to a lack of operating earnings and net tangible assets. The popularity of SPAC has increased in the United States. All SPAC transactions are supervised by the US Securities and Exchange Commission.

To guarantee openness and integrity, the SEC has imposed stringent SEC filing, reporting, and disclosure requirements for SPAC transactions. Because of SPAC's well-regulated status in the United States, sponsors and investors have come to see it as a superior alternative to traditional IPOs.

Furthermore, each stock exchange has its own SPAC laws. For example, the London Stock Exchange requires a listed business to delist and reapply in the event of a reverse merger with another listed entity, but the Australian Securities Exchange permits reverse mergers on a case-by-case basis. Canada, too, has SPAC regulatory standards and is aggressively promoting them.[14]

SPACs are currently not subject to any extensive regulatory restrictions set by the Indian legislation. However, India's market regulator, the Securities and Exchange Board of India, has set up a committee of specialists to look at the possibility of introducing SPAC laws in India, which may improve the chances of start-ups listing domestically.[15]

Because India's IPO market is large and developed, SPAC has a good chance of succeeding there as well. Flexible regulations encompassing elements such as incorporation, compliance, and governance will need to be developed if India contemplates SPAC listing.

VI. RISK FACTORS INVOLVED FOR INVESTORS AND POSSIBLE REGULATORY AMENDMENTS AND FUTURE OF SPAC

Although SPACs make it easier and faster for start-ups to list, it also means that the lengthy and expensive listing procedure is bypassed, posing a significant risk to retail investors. Because India lacks a defined structure for SPACs, listed businesses may not be able to redeem

[13]. *Supra* note 10

[14]. *Supra* note 1

[15]. *supra* note 9.

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their shares under existing rules. Once again, India may take a page from the United States of America and change rules to allow investors to either redeem their own or seek a refund of the amount they invested before the target corporation's purchase.

Stamp duty obligations are another major regulatory hurdle that SPACs must overcome. Start-ups prefer the SPAC path to list because it is more cost-effective. The transactions through SPAC, on the other hand, take the form of a reverse merger, which is subject to high stamp duties. As a result, the merger plan must be launched and approved by the tribunals, resulting in a slew of Companies Act, 2013 compliance difficulties. A prospective stamp duty exemption for SPAC transactions might be an efficient approach to promote the SPAC route of listing.[16]

VII. CONCLUSION

Some of India's current rules and regulations are impeding the growth of SPAC. Some of these are outdated and need to be updated in light of the current situation of the Indian economy. Shell corporations must be defined, and public beliefs that they are largely used for money laundering must be changed. A special committee should be formed to investigate the impact of SPAC in other nations, particularly in terms of reviving their start-up industries. SPACs are distinct from traditional public corporations, and as a result, they require special legislation. A distinct chapter of the Companies Act should handle the formation of a SPAC, as well as compliance and governance issues relating to its management, board, and shareholders. A SPAC can rule under regular terms once it has completed its purchase. Similarly, all applicable legislation and listing requirements require distinct provisions/chapters. In many respects, India's taxation structure is similarly anti-SPAC. The Indian tax authorities, for example, do not let foreign listed SPACs purchase Indian start-ups without paying capital gains tax. As a result, the capital gain is passed on to the shareholders. Allowing SPAC transactions in India is vital. Because both the SPAC and the target entity are headquartered in India, such a transaction would be structured as a merger under a scheme of amalgamation. These types of transactions are tax-free. This will also ensure that the stockholders engaged are not subject to any tax obligations.

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[16]. *supra* note 10.

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