

GIFT City Express

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GATEWAY FOR SPACS IN INDIA: NEW FRAMEWORK NOTIFIED IN GIFT CITY

The International Financial Services Centre Authority (“**IFSCA**”) recently released the IFSCA (Issuance and Listing of Securities) Regulations, 2021 (“**Regulations**”). These are meant to serve as an all-encompassing unified regulatory framework specifying the requirements for issuance and listing of various types of securities, and disclosures.¹ The Regulations seek to create an ecosystem for listing of Special Purpose Acquisition Companies (“**SPACs**”) and of depositary receipts on the stock exchanges in the International Financial Services Centre (“**IFSC**”). They also provide for issuance and listing of securities by start-ups, Small and Medium Enterprises (“**SMEs**”), and debt securities focusing on Environment, Social and Governance (“**ESG**”).

OVERVIEW OF REGULATIONS

General Eligibility Criteria

- **Eligible Issuers:** Companies incorporated in foreign jurisdictions, in India, and in the IFSC are to be eligible to list their securities on a stock exchange in the IFSC recognized by the IFSCA (i.e. a Recognized Stock Exchange, or “**RSE**”).

The Regulations also seek to make the following entities eligible to list debt securities² on an RSE:

- a) Any supranational, multilateral, or statutory organization, institution, agency provided it is permitted to issue securities as per its constitution documents;
 - b) Any municipality, statutory body, board, corporation, authority, trust or agency established or notified by any Central or State Act or any Special Purpose Vehicle notified by the State Government or Central Government including for the purpose of raising fund by the issuer to develop SMART city; and
 - c) An entity whose securities are irrevocably guaranteed by a sovereign.
- **Eligibility Criteria:** An issuer shall be eligible to list its securities in IFSC only if:
 - a) the issuer is duly incorporated or established according to the laws of its place of incorporation or establishment;
 - b) the issuer is operating in conformity with its constitution; and
 - c) the listing of securities in IFSC is in accordance with the laws of the jurisdiction of incorporation.

The Regulations disqualify issuers if the issuer or any of its promoters, promoter group, controlling shareholders, directors or selling shareholders is:

- a) Debarred from accessing the capital market; or
 - b) A willful defaulter; or
 - c) A fugitive economic offender.
- **Securities:** The securities proposed to be listed on an RSE should be freely transferable, and held in dematerialized form.

Listing of SPACs

The Press Release by the Ministry of Finance announcing the release of the draft Regulations in March 2021 noted that SPACs have become an important and innovative structure to raise capital through an Initial Public Offer (“**IPO**”) for acquiring companies or assets, globally. Keeping pace with the evolving market, the Regulations seek to provide a suitable framework for raising capital and listing of SPACs on RSEs.

The key tenets proposed for listing of SPACs are:

S No	Parameter	Description
1.	Eligibility Criteria	<p>The issuer should qualify both the following conditions:</p> <ul style="list-style-type: none">a) the target business combination³ has not been identified prior to the IPO; andb) the SPAC has provisions for redemption and liquidation in line with the Regulations <p>Further, the SPAC sponsor should have a good track record in SPAC transactions / business combinations / fund management / merchant banking</p>

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- activities, which should be disclosed in the offer document.
2. **Listing Process** Requirements and filings for traditional IPO to apply. Proposed SPAC listing to be considered by IFSCA on a case-by-case basis.
 3. **Offer Timing** The offer is required to be made within 1 year from when the IFSCA issues its observations. Else, fresh draft of the offer document will need to be filed.
 4. **Issue Size**

Minimum of USD 50 million, or as specified by the IFSCA. SPAC sponsors⁴ are required to hold at least 15% and not more than 20% of the post issue paid-up capital of the SPAC.

The SPAC sponsors are also required to have aggregate subscription in the SPAC prior to or simultaneous to the IPO, amounting to at least 2.5% of the issue size or USD 10 million, whichever is lower; or as may be prescribed by the IFSCA.
 5. **Pricing** The issuer shall determine price in consultation with lead manager. The price of the equity shares in the IPO shall not be less than USD 5 per share
 6. **Offer Period** To be kept open for minimum 3 working days, and maximum 10 working days.
 7. **Minimum Subscription** At least 75% of offer size and minimum number of subscribers shall be 50.
 8. **Application and Allotment**

Minimum application size to be USD 100, 000.

No single application to be allotted more than 10% of post issue paid-up capital. Allotment to investors to be proportionate or discretionary basis, per offer document disclosures.
 9. **IPO Proceeds**

Entire IPO proceeds to be kept in interest-bearing escrow account controlled by an independent custodian, until the business acquisition is complete. The escrow funds shall be invested only in instruments disclosed in the offer document and shall include only short-term investment grade liquid instruments.

The interest and other income derived from the amount placed in the escrow account may be withdrawn by the SPAC issuer for (a) payment of taxes; and (b) working capital expenses, subject to prior approval by way of special resolution of shareholders other than sponsors.
 10. **Business Acquisition / De-SPAC transaction**
 - The SPAC shall seek prior approval by way of majority of shareholders other than sponsors, for the proposed business combination. Dissenting shareholders (other than sponsors) shall have redemption rights for converting their securities into a pro rata portion of the aggregate amount held in the escrow account (net of taxes payable);
 - To be completed within 36 months of listing on RSE, as approved by majority votes of investors (except sponsors). If not completed in this time, the escrow will need to be liquidated. Sponsors cannot participate in any such liquidation distribution.
 - Aggregate Fair Market Value of the acquisition should be at least 80% of amount in escrow.

COMMENTS

SPAC regimes have been in existence in several jurisdictions, such as the United States, the United Kingdom and Canada, since a long time. However, their immense popularity is recent. In 2021, SPACs have raised a record USD 100 billion with 341 global IPOs.⁵

SPACs, also called 'blank-cheque companies', are essentially shell entities created to facilitate the financing of business acquisitions. They reverse the traditional IPO process, such that SPACs first raise money from investors and subsequently acquire a company using those funds through a merger or other method. This provides the target company a direct route to listing on a stock exchange that may not be otherwise accessible.

Since SPACs do not have any operations, investors typically invest in SPACs based on the track record of founders. Hence, as a safeguard, regulations generally require that funds raised by IPO be maintained in escrow till the time the business acquisition, also known as the "**De-SPAC transaction**", is completed. Founders have a fixed period from listing, to identify a target company. From a founder's perspective, a SPAC offers huge upside as founders typically get around 20% of the fully diluted capital of the SPAC on successful consummation of the De-SPAC transaction.

There are several reasons why SPACs have gained popularity recently. While the traditional IPOs continue, SPACs offer a quicker and less cumbersome method to raise capital. Traditional IPOs on domestic exchanges may also not provide as much value as foreign stock exchanges, not to mention that in many jurisdictions, listing regulations require a company to display a financial track record that a SPAC is unable to do. Indian companies also have the option of listing on foreign stock exchanges through the issuance of American depositary receipt ("**ADR**") / global depositary receipts ("**GDRs**"), however, the regulations allow only a listed company to make an ADR / GDR issue. While the Indian government has long been mulling options to allow direct listing of Indian companies outside India, those regulations remain awaited.

Specifically, during last year, investors and founders have clearly found SPACs to be more favourable during the disruption caused to traditional IPOs by COVID-19. Several large private equity players like Apollo Global

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An Indian company substantially held by foreign shareholders that have invested prior to March 31, 2017 through a treaty jurisdiction (such as Mauritius or Singapore) may be a good choice for a SPAC target, owing to grandfathering of capital gains tax exemptions under those treaties.

Proposal for SPACs in the IFSC

All of the aforesaid addresses SPACs listed in foreign markets, and not in India. Currently, there is no specified regulatory framework for SPACs in India. Given that SPACs are shell companies, they may be struck off from the register of companies under the Companies Act, 2013. Further, listing of a SPAC-like entity on Indian stock exchanges can be challenging owing to requirements to demonstrate financial track record. Considering the above, it is clear that the Regulations are well timed, may offer several opportunities for Indian start-ups and promoters to externalize their structures.

Establishing a SPAC in the IFSC may help resolve certain issues that Indian start-ups and promoters could face with a foreign SPAC. Typically, there two ways in which a De-SPAC transaction may take place. First, a SPAC may simply acquire an identified Indian target and second, the identified Indian company may be folded up in the SPAC through a merger.

In case of direct acquisition by a SPAC of an Indian target company, there will be a secondary sale of shares of the Indian company. The transfer of shares of an Indian company to the SPAC (whether foreign SPAC or an IFSC SPAC) by foreign shareholders would be subject to tax in India unless, the foreign shareholder has invested through a treaty jurisdiction and is eligible for tax exemption. Further, there may be implications under the indirect transfer tax provisions if the foreign SPAC is deriving substantial value from the Indian company. In case of an IFSC SPAC (i.e. a SPAC incorporated in the IFSC) holding an Indian company, this issue does not arise for foreign shareholders as the IFSC SPAC is considered to be an Indian resident from tax perspective and transfer of shares of the SPACs by non-residents is exempt from tax under the ITA provided the consideration for such transaction is paid or payable in foreign currency. As far as Indian shareholders are concerned, there are regulatory challenges to the Indian shareholders holding shares in a SPAC (whether foreign SPAC or an IFSC SPAC). In this regard, the market practice is that the Indian shareholders usually enter into a put-option agreement with the SPAC wherein the SPAC agrees to buy the shares held by the Indian shareholders at a specified price.

In case the Indian company is folded up in the SPAC through a merger, the implications may differ depending on whether the SPAC is a foreign SPAC or an IFSC SPAC. The merger of an Indian company with a foreign SPAC (outbound merger) is permitted under the Companies Act, 2013 provided prescribed conditions are fulfilled⁷ and after obtaining prior approval from the Reserve Bank of India ("RBI").⁸ However, outbound mergers have not been accorded tax neutrality under the (Indian) Income-tax Act, 1961 ("ITA"). Accordingly, capital gains (if any) should be subject to tax in the hands of the Indian company (on transfer of assets to the SPAC) as well as the shareholders of Indian company. However, in case of merger of an Indian company with an IFSC SPAC, the merger will be akin to a merger of two domestic companies and accordingly, the complications in relation to outbound merger should not arise. Once a SPAC is listed on the RSE in the IFSC, transfer of shares of the SPACs by non-residents is exempt from tax under the ITA provided the consideration for such transaction is paid or payable in foreign currency.⁹

The Regulations in relation to SPACs mimic the regulatory framework worldwide. Considering the benefits of SPACs in the IFSC, the structure may be a feasible one for Indian start-ups and promoters, giving them opportunities to raise capital from non-resident investors. Having said this, the success of the SPAC IPO in the IFSC will depend on the marketability of securities on the RSE in the IFSC and also the comfort of investors in investing in the IFSC, aspects only time can provide clarity on.

– Ipsita Agarwalla, Varsha Bhattacharya & Parul Jain

You can direct your queries or comments to the authors

¹ Previously, the listing of equity shares in the IFSC by companies incorporated in India and in a foreign jurisdiction was regulated by a combination of the SEBI (IFSC) Guidelines, 2015, the SEBI (Issue of Capital and Disclosure requirements) Regulations, 2018, the Companies Act, 2013 and the foreign currency depository receipt scheme and circulars issued thereunder. Further, listing of debt securities in the IFSC was also regulated by the SEBI (IFSC) Guidelines, 2015 and the framework provided by the recognised exchanges in IFSC. The IFSCA had also provided the regulatory framework for listing of Depository Receipts by way of a circular in October 2020.

² Debt securities have been defined to mean non-convertible debt securities which create or acknowledge indebtedness and include debentures and bonds.

³ Business combination has been defined to mean a merger or amalgamation or acquisition of shares or assets of one or more companies having business operations

⁴ Sponsor has been defined to mean a person sponsoring the formation of the SPAC and shall include persons holding any specified securities of the SPAC prior to the IPO

⁵ Reuters. May 20, 2020. SPACs raise record \$100 billion in IPOs so far this year. Economic Times. Accessed at: <https://economictimes.indiatimes.com/markets/ipo/spacs-raise-record-100-billion-in-ipo-so-far-this-year/articleshow/82802721.cms?from=mdr>

⁶ Debevoise & Plimpton, PE Jumps into SPAC markets

⁷ This will include procedural requirements such as filing an application before the jurisdictional NCLT, conducting meetings of shareholders / creditors, notification to income-tax authorities, other sectoral regulators etc., publication of advertisement in respect of the merger, etc.

⁸ The RBI has also notified the Foreign Exchange Management (Cross Border Merger) Regulation, 2018, dealing with cross border mergers and laying down conditions for cross border mergers from an exchange control law perspective.

⁹ Section 47(viib) of the ITA

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