

# Special Purpose Acquisition Companies in India: Addressing the Tax Reality Behind the Façade

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## Introduction

Special Purpose Acquisition Companies (SPACs), as an alternative investment vehicle, have disrupted securities markets in recent years. These investment vehicles facilitate going public through diversion from the dominant pathway of traditional initial public offer (IPO) and dismantling the traditional capital markets.<sup>1</sup> SPACs are often touted as ‘poor man’s private equity’,<sup>2</sup> for they ease attracting public capital and simplify the legal process of tapping public resources. Though it is a useful financial tool and the fastest way to reach public markets, one has to exercise due caution to not risk overvaluation and conduct rounds of due diligence to protect the interest of the investors. SPAC IPO binge is constantly on the rise in many jurisdictions. The surge was found to be extraordinary in 2021 with more than 39% of global IPOs attributed to SPAC listings.<sup>3</sup> The US is a hotbed for SPAC with USD 162.6 billion, a never seen sight of SPAC listing deals.<sup>4</sup>

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<sup>1</sup> C Duhigg, ‘The Pied Piper of SPACs’, *The New Yorker* (Jun. 7, 2021).

<sup>2</sup> L Dimitrova, ‘Perverse incentives of special purpose acquisition companies, the “poor man's private equity funds”’ (2017) 63 *J Acc & Econ* 99.

<sup>3</sup> Jens Kengelbach, Lianne Pot, *et. al.*, *The SPAC Bust Could Be a Boon for Targets* (Jan. 31, 2023), <https://www.bcg.com/publications/2023/blank-check-bust-could-benefit-spac-merger-targets>.

<sup>4</sup> Andrew Hammond and Joel L. Rubinstein, *SPACs struggle amid regulatory uncertainty and volatile markets*, *White & Case*, (27 Jan. 2023), <https://www.whitecase.com/insight-our-thinking/us-ma-fy-2022-spacs-struggle-regulatory>.

Given the boom in SPAC around the world, there has been a considerable rise in the number of Indian companies flipping their structure outside the country to list on foreign stock exchanges. Indian entities such as PayTm, Policybazaar, Delhivery, and Freshworks also considered the SPAC route to be worth visiting, making it a relevant point of consideration for policymakers. Trends show that the SPAC route is a popular mode used by entities to list themselves outside the territory. Given the uphill situation, the Economic Survey of 2023 contained an extensive discussion on the reverse flipping of companies back into the nation. However, such combat would not be effective if SPAC remains to be a shell company in the letter and spirit of the Companies Act, 2013. To overcome this legal adversity, the International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 (IFSCA (IALS) Regulations) was enacted to regulate and allow SPAC to some extent in India. Irrespective, there have been no successful listings of SPACs or reverse flipping of entities in India.

Indeed, the regulatory regime for SPAC is not uniform and is evolving in many jurisdictions. To add, the emerging supremacy of SPAC has not been studied properly in India, making an academic discourse much needed and pertinent. Said that the article is structured into four parts. Part I of this article deals with identifying the definition of SPACs, their evolution, and the working of SPACs, and analyzing the structuring by adopting a case study method. Whilst analyzing the legal and regulatory framework that would help in making India, an attractive destination for the listing of SPACs, Part II of the research focuses on highlighting the taxation implications on the SPACs and arguments that highlight the need for balance between the law and the idea of attractive destination. To this end, this contribution thrives to seek an answer to a fundamental question: Is SPAC truly an alternative investment fund or is it merely a reality lying underneath the façade unaddressed?

## Decoding SPACs

### Definition in Indian Laws

Special Purpose Acquisition Companies aim to provide private companies and start-ups with innovative and novel capital-raising opportunities without having to adhere to legal formalities and complexities to go public.<sup>5</sup> They act as an alternative to traditional IPOs, allowing the infusion of more funds across sectors. The term SPACs is defined under Reg. 2 (s) of the IFSCA (IALS) Regulations, 2021. SPACs are companies that do not have an operating business and work only towards affecting a business combination.<sup>6</sup> The term business combination is defined under Reg. 2 (b) to mean the merger or amalgamation, or acquisition of shares or assets of one or more companies that have business operations.<sup>7</sup> Combined, SPACs are primarily blank check companies/ shell companies with no operations of their own and operate only to effect a combination of an existing private business.

SPACs, with no business of their own, retain the character of a cash shell company and lie dormant for future use.<sup>8</sup> Cash shells are different from natural shell companies. Cash shells intend to raise funds from the public to help a third-party company go public whereas natural shell companies are those that either became bankrupt or have sold a large part of their assets.<sup>9</sup> They are publicly listed companies that go public and sell their shares to investors in an IPO to raise their own funds prior to the acquisition of the

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<sup>5</sup> GoI, Report of the Company Law Committee 2022,,61, Para 22.1.

<sup>6</sup> IFSCA (IALS) Regulations, 2021, Reg. 2 (s).

<sup>7</sup> *Id.* Reg. 2 (b).

<sup>8</sup> Michael Klausner, Michael Ohlrogge & Emily Ruan, A Sober Look at SPACs, 39 YALE J. ON REGUL. 235 (2022).

<sup>9</sup> Johannes Kolb and Tereza Tykvova, 'Going public via special purpose acquisition companies: Frogs do not turn into princes' (2016) 40 J. Corp. Fin. 82.

target company.<sup>10</sup> With funds raised, they are provided with a stipulated time frame to identify and acquire the target company. The time frame varies between eighteen months to twenty-four months to identify a target company for the merger,<sup>11</sup> until which the proceeds of the first IPO shall remain in an escrow account.<sup>12</sup> After the acquisition of the target company, SPAC demerges, leaving the target company on the stock exchange which remains listed through the indirect listing.<sup>13</sup>

### **Evolution of SPAC in India**

The forerunner to SPAC and its origins can be traced back to the 1980s when blank check IPOs were issued for penny stocks. Penny stocks were traded by brokers through telephones and computers without a proper trading mechanism.<sup>14</sup> Trade typically took place through blank check offerings where security is issued without disclosing any specific business plan or purpose, allowing users to use funds at their discretion without any restrictions or limitations. This over-the-counter market trading and blank check practice led to several instances of fraud, abuse, and eventual loss to the investors until it was curbed through Rule 419 of the Securities and Exchange Commission Rules, 1934, and enactment of Securities Enforcement Remedies and Penny

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<sup>10</sup> GoI, Report of the Company Law Committee 2022, 61, Para 22.2 r/w IFSCA (IALS) Regulations, 2021 Reg. 67.

<sup>11</sup> Harald Halbhuber, Economic Substance in SPAC Regulation, YALE J. ON REGUL. 45 (2022).

<sup>12</sup> Kurt Chauviere, Alastair Green, and Tao Tan, Earning the Premium: A Recipe for Long-Term SPAC success, McKinsey & Co, (Sep. 2020).

<sup>13</sup> Supra note 8 at 61.

<sup>14</sup> US Report to Congressional Committees, Penny Stocks: Regulatory Actions to Reduce Potential for Fraud and Abuse, 5 (Feb.1993), <https://www.gao.gov/assets/ggd-93-59.pdf>.

Stock Reform Act of 1990.<sup>15</sup> In 2019, the concept of a blank check company was expanded to include within its fold, a development stage company having the plan to merge or acquire with an unidentified target.<sup>16</sup> Therefore, it can be validly held that SPACs of today are merely a refined and modern descendant of blank check companies of the 1980s with one consistent common objective- SPAC through merger and De-SPAC through de-merger.

The life of SPAC starts with the raising of funds through an initial IPO. IPO of a SPAC, in reality, is funded by sponsors. Sponsors are largely limited liability companies and highly experienced founders interested in acquiring the target company.<sup>17</sup> Sponsors hold a stake in SPAC and play a pivotal role in attracting investors to contribute to the trust fund and proceeds of SPAC IPO.<sup>18</sup> Sponsors hold a stake in SPAC through varied instruments ranging from founder shares, private placement warrants, public shares, and public warrants.<sup>19</sup> Founder shares are the ones that are issued by the founders to the sponsors and their affiliates in a SPAC formation whereas private placement warrants are debt funds that can be converted to equity at a later point by a sponsor.<sup>20</sup> Public shares and public warrants generally involve general public

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<sup>15</sup> Max H Bazwerman and Paresh Patel, SPACs: What You Need to Know, HBR (Jul-Aug 2021), <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

<sup>16</sup> SEC, Amendment No. 2 to Offering Statement on Form 1-A (Mar. 5, 2019) <https://www.sec.gov/Archives/edgar/data/1760319/000176031919000008/filename1.htm>.

<sup>17</sup> *Supra* note 15.

<sup>18</sup> Manohar Samal, Bhavana J Sekhar, Sathyajith MS, An Indian Perspective on Special Purpose Acquisition Companies, GLA-TR-001.

<sup>19</sup> Finvox, Special Purpose Acquisition Company- An Alternative to Traditional IPOs, Chap.4, <https://www.finvocanalytics.com/wp-content/uploads/2021/07/Valuation-Professionals-Insights-Series-6-chapter4.pdf>.

<sup>20</sup> Deloitte, A Closer Look Financial reporting considerations for Special Purpose Acquisition Companies, (May 2021), <https://dart.deloitte.com/UKGAAP/pdf/68d53ecd-b7f8-11eb-9ea5-0fe89cddf7fa>.

interest in the company through IPO proceeds.<sup>21</sup> Private investments in public equity connecting a SPAC and de-SPAC have recently carved their space as a popular equity commitment instrument.<sup>22</sup> A typical SPAC merger and demerger would have an interplay of the above-mentioned instruments with its own set of adjustments before leaving the target company on a stock exchange.

### **Structuring and working of SPAC: Case Studies**

Overseas listing of Indian companies using SPACs is gaining momentum and is consistently on the rise. SPACs have become increasingly popular in recent years as a vehicle for Indian companies to go public and gain access to public markets at ease.

One of the first companies to have listed outside India is Yatra Online, Inc., (Yatra) in NASDAQ in December 2016.<sup>23</sup> To list in NASDAQ, the transactional structure worked as follows: An entity named Terrapin 3 Acquisition Corporation (Terrapin), a SPAC was formed to achieve the business combination of Yatra.<sup>24</sup> The SPAC raised millions in its IPO before using the proceeds raised to acquire the target company. In the target period,

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<sup>21</sup> EY, No. 2021-03, Technical Line A closer look at accounting for financial instruments issued by SPACs, 3 (Mar. 2022).

<sup>22</sup> Clifford Chance, Guide to Special Purpose Acquisition Companies, 8, <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/09/guide-to-special-purpose-acquisition-companies.pdf>.

<sup>23</sup> Prashanth Perumal, Here's the Indian travel company that just went public on the Nasdaq, Business Insider (Dec.21, 2016).

<sup>24</sup> US SEC, Form 6\_K, Yatra Online, Inc. 2 [http://q4live.s22.clientfiles.s3-website-us-east-1.amazonaws.com/850749348/files/doc\\_financials/quarterly\\_reports/2017/10Q-2017-Q3.pdf](http://q4live.s22.clientfiles.s3-website-us-east-1.amazonaws.com/850749348/files/doc_financials/quarterly_reports/2017/10Q-2017-Q3.pdf).

Yatra and Terrapin entered into a merger agreement that allowed the merger of the two entities.<sup>25</sup> This agreement also permitted Yatra to issue shares to Terrapin which used its proceeds to acquire shares and in turn allow Yatra to become a public company, which was followed by de-SPAC, the reverse merger process to put Yatra in public markets, bypassing the traditional IPO process.<sup>26</sup> Upon demerger, Yatra did US Securities and Exchange Commission (SEC) compliance and began trading in the symbol of ‘YTRA’.<sup>27</sup>

Prior to Yatra going public via NASDAQ, MakeMyTrip Ltd., having a similar line of business activity also went public by listing itself on NASDAQ in August 2010. To achieve the intended outcome, MakeMyTrip flipped outside India through the process of incorporating a holding company named MakeMyTrip Limited, Mauritius.<sup>28</sup> The parent holding in Mauritius in turn followed a traditional IPO path complying with US SEC and listing itself in NASDAQ. Of multiple ways to externalize and list outside India, flipping through holding structures was a popular way until it became replaced by the popular SPAC route of the Yatra.<sup>29</sup>

A deal that recently got closed through the SPAC route had grabbed the attention of the government and masses which was in the renewables sector -

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<sup>25</sup> *Id.*

<sup>26</sup> Yatra, Yatra Online, Inc.’s Indian Subsidiary, Yatra Online Limited, Files Draft Red Herring Prospectus (Mar. 25, 2022) <https://investors.yatra.com/press-releases/press-release-details/2022/Yatra-Online-Inc.s-Indian-Subsidiary-Yatra-Online-Limited-Files-Draft-Red-Herring-Prospectus/default.aspx>

<sup>27</sup> Yatra Online Ltd., Draft Red Herring Prospectus, 191, <http://www.cmlinks.com/pub/dp/dp68113.pdf>.

<sup>28</sup> MakeMyTrip Filings before SEC, Corporate Structure, 3, <https://www.sec.gov/Archives/edgar/data/1495153/000095012311055159/u00846de424b1.htm>

<sup>29</sup> Ayesha Battacharya, Externalization of Start-ups: Exploring the Flip Side, *Bus. L.R.* 42 (5) (2021).

Renew Power Private Limited. The company has subsidiaries all over the country and an enterprise in Singapore undertook developmental and incidental electricity services.<sup>30</sup> In August 2021, the company went into the listing in NASDAQ through Renew Energy Holdings Plc, UK, having the UK entity as its holding company.<sup>31</sup> This was achieved through a business combination and a merger deal that formed SPAC, RMG Acquisition Corporation II.<sup>32</sup> This SPAC was formed by merging a wholly owned subsidiary company, Renew Power Global Merger Sub, a corporation in the Cayman Islands. Instruments used in the transaction were primarily private placements in public equity that allowed the acquisition and listing of shares of Renew Power, India.<sup>33</sup>

## Evaluating SPAC Transactions through Taxation Lens

Under the Indian Companies Act, 2013, a company not commencing business operations after obtaining a certificate of incorporation is considered to be a company that is inactive. Such inactive companies, after identification, would typically be struck off from the register as maintained by the Registrar of Companies. This is one of the major reasons for not having any SPAC listing on the Indian stock exchange. Further, no law has permitted direct listing in India yet, even though attempts and a few laws have been brought on that

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<sup>30</sup> ReNew Power, History and Certain Corporate Matters, 194, [https://www.sebi.gov.in/sebi\\_data/attachdocs/may-2018/1525930664430.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/may-2018/1525930664430.pdf).

<sup>31</sup> ReNew Power, Sustainability Report, 11, [https://renewpower.in/wp-content/uploads/2021/10/ReNew\\_Sustainability\\_Report\\_2020-21.pdf](https://renewpower.in/wp-content/uploads/2021/10/ReNew_Sustainability_Report_2020-21.pdf).

<sup>32</sup> Vibhuti Garg, Renewable Energy Investment Surges in India Investment Will Need to More Than Double to Meet 2030 Goals, IEEFA (Jun. 2022), [https://ieefa.org/sites/default/files/2022-06/Renewables%20Investment%20Trends%20in%20India-June\\_2022.pdf](https://ieefa.org/sites/default/files/2022-06/Renewables%20Investment%20Trends%20in%20India-June_2022.pdf).

<sup>33</sup> Aniruddha Jain, ReNewing through SPAC (Mar. 17, 2021), <https://mnacritique.mergersindia.com/renew-power-listing-spac-merger/>.



front.<sup>34</sup> Sec.23 of the Companies Act permits Indian public companies to do direct overseas listing of their equity and debt instruments apart from the indirect listing of American Depository Receipts and Global Depository Receipts.

SPAC and De-SPAC help Indian companies list in foreign exchange through traditional methods, as in the case of Yatra, listing by way of a merger with SPAC or can become a subsidiary through an indirect method as in the case of Renew Power. Indian Tax Laws have always been a subject matter of debate in terms of international and innovative transactions. There have been controversial amendments and stirring discussions on the applicability of domestic legislation to an income that arises, accrues, is deemed to arise, or accrues outside India. SPAC in specific, can provide a significant impact on returns that are generated, making the SPAC transactions not an exemption to Indian tax implications.

To begin with, most transactions routed via SPAC are likely to attract capital gains taxation in India. The attraction of capital gain depends on the structure and instruments involved in the transaction. There are different implications of tax during the de-SPAC period and post De-SPAC. During the De-SPAC period, SPAC and the target company normally undertake a share swap to achieve the intended objective. Swaps allow both residents and non-residents to hold shares of the Indian company, thereby becoming shareholders of an Indian entity. This shareholding can be considered as an asset or income arising through capital assets that are situated in India.<sup>35</sup> Capital gains would be attracted also when the shares of the Indian target are sold outside the

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<sup>34</sup> NDA, Gateway for SPACs in India: New Framework Notified in Gift City, (Jul. 23, 2021), <http://nishithdesai.com/SectionCategory/33/GIFT-City-Express/12/71/GIFTCityExpress/4754/1.html>.

<sup>35</sup> The Income Tax Act, 1961, Sec. 2 (14).

country for cash consideration.<sup>36</sup> Further, the Indian Income Tax Act, of 1961 establishes a tax-neutral ground for the merger and amalgamation of two Indian entities.<sup>37</sup> In a SPAC route, the merging entity is a foreign entity that would derive the substantial value of the transactions from assets located in India, thereby establishing a business connection with India and attracting significant tax in India.<sup>38</sup>

Tax implications can also arise post De-SPAC, where any consideration received, or income earned by an Indian entity can be construed as capital assets in India since the substantial value would be derived from India. Further, with the new amendments to the Income Tax Act, 1961 where the global income of an Indian resident is not subjected to tax in any other jurisdiction, then the whole of the worldwide income shall be subjected to tax in India.<sup>39</sup> Yet another instance of taxation during De-SPAC is when the Indian entity merges with a foreign entity creating a branch office or a permanent establishment of the SPAC in India.<sup>40</sup> A permanent establishment effectively established would be subjected to tax in India when it is proved that the transactions have not taken place on an arm's length basis.<sup>41</sup> Either way, the transaction would be subjected to transfer pricing regulation and further result in the creation of a holding-subsidary relationship.

Apart from the permanent establishment, Place of Effective Management (PoEM) is also a pertinent factor to be looked into when Indian entities merge

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<sup>36</sup> *Id.* Sec. 45.

<sup>37</sup> *Id.* Sec. 47.

<sup>38</sup> *Id.* Sec. Sec. 9 (1) (i).

<sup>39</sup> *Id.* Sec. Sec. 6 (1A).

<sup>40</sup> PwC, Rise of SPACs: An Indian Perspective (May 2021), <https://www.pwc.in/assets/pdfs/services/deals/rise-of-spacs-an-indian-perspective.pdf>.

<sup>41</sup> *Id.*

with foreign entities and further de-merge. Underlying PoEM is estimated according to the place where the key managerial and commercial decisions of the company are undertaken.<sup>42</sup> Where it could be proved beyond a reasonable doubt, that the active business of the SPAC was managed from India as a seat, then there shall be tax incurred on the same. Further, the concept of PoEM is much wider and has a broad base as compared to permanent establishment, which implies the high likelihood of global income tax in India.

Apart from capital gains taxation, a company listing in a foreign stock exchange has quite a few considerations to take note of. Firstly, a De-SPAC transaction involving a share exchange with the employees or providing an employee with a stock option also attracts a possibility of exposing the employees to tax in India.<sup>43</sup> Secondly, any tax attracted on the consideration paid or received would be on the basis of fair market value. Determining fair market value in India is a task in itself since there is a multitude of methodologies and valuation norms provided within the legislation.<sup>44</sup> Thirdly, SPAC transactions involve different jurisdictions, which would allow the taxpayer to choose a commercially viable option favourable to him as against an option available in the hands of the Department of Revenue. When questions of conflict arise, the price difference can be construed as deemed to be income and be subjected to tax at a higher rate.<sup>45</sup> Fourthly, the Indian Income Tax Act, 1961 allows companies to carry forward business loss and unabsorbed depreciation in a given financial year.<sup>46</sup> Where the company opts for SPAC and De-SPAC, the benefits of carry forwarding loss

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<sup>42</sup> The Income Tax Act, 1961, Sec. 6 (3).

<sup>43</sup> *Id.*, Sec.112A.

<sup>44</sup> *Id.*, Sec.50CA and The Income Tax Rules, 1962, Rule 11UA.

<sup>45</sup> *Id.*, Sec. 66 and Sec.56 (2) (x).

<sup>46</sup> *Id.*, Sec. 35AD.

and remaining depreciation does not get accounted for since they merge with SPAC outside India. Lastly, as a result of the SPAC transaction, if the Indian target entity remains as a subsidiary of SPAC, any profits that are earned if it has to be repatriated would attract withholding taxes in the hands of the remitter. All these implications need to be necessarily and carefully evaluated by Indian target entities and foreign SPAC to achieve better results. Additionally, active steps have to be taken to provide leverage in tax laws to make Indian territory an attractive SPAC destination. Without due changes and modifications in Income Tax and allied legislations, SPAC shall remain a façade behind reality.

### **Conclusion: Is SPAC truly an Alternative Investment Fund?**

Apart from the recent initiative IFSCA (IALS) Regulations, 2021, the regulatory framework in India is not very conducive to having SPAC transactions. Even the 2021 Regulations have three major issues to be sorted. One, the facilitation factor between entrepreneurs and alternative investment techniques of SPAC has to be increased. Two, while the promotion of SPAC is essential, due care must be taken to protect retail investors, sponsors, and other investors opting for SPAC. Three, corporate governance mechanisms have to be streamlined and adapted to suit the needs of changing times and incorporate a framework to govern SPAC while also strengthening the working of SPAC in India. Further, there is a need to relook into laws relating to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, and with Foreign Exchange Management (Cross Border Merger) Regulations, 2018 to well suit SPAC listings in India.

The last decade has witnessed an immense increase in the number of companies choosing to list onshore using the SPAC route. Reasons often quoted for such listing are an attraction of global investors, infusion of global funds into Indian companies, and quicker and highly effective means of listing without the hassle involved in traditional IPOs. However, with global turmoil and higher standards of Corporate Governance practices, the costs to be borne for SPAC could actually be more than the benefits. Further, countries like India are still protective and apprehensive of round-tripping of funds into India. Though IFSCA (IALS) Regulations, 2021 is a framework in the right direction, with no SPAC listing in India, the Regulations remain as a clawless tiger. Further, IFSCA (IALS) Regulations must consider addressing concerns relating to disclosure norms of how and why a particular target is chosen and the possible conflict of interest between the sponsor, SPAC, and the target entity. The possibility of SPAC succeeding or failing in India depends not only on IFSCA (IALS) Regulations but also on subsequent amendments in wider corporate laws, foreign exchange laws, and laws in pari materia. Further, with broad spectrum tax law implications, SPAC might not in reality act as an alternative investment fund in India. Hence, the best lessons have to be learned and incorporated into Indian laws to enable Indian companies to access the SPAC route both nationally and internationally.