

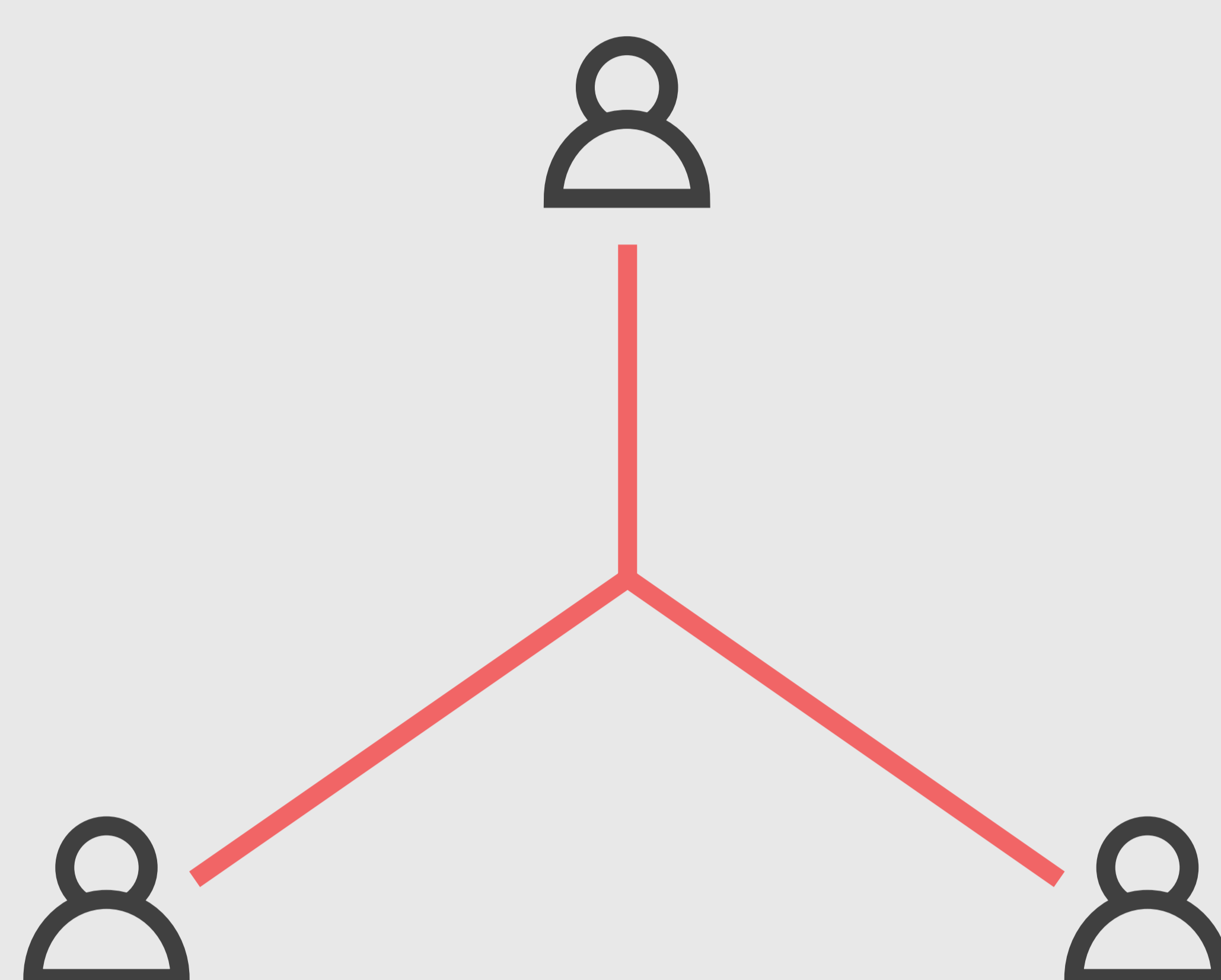
Externalisation Of Holding Structure

A Trend in Vogue for Startups



Many investors (individually and collectively) flock to startups which could possibly provide a high return on their investment. As the sector matures, new investment structures evolve; externalisation is one such structure. As regulators grasp the nuances of externalisation, they introduce new laws or amend the existing ones to suit such structures.

The current regulations applicable to the externalisation transactions are at a nascent stage as discussed in Part 1 of this Series. However, there are amendments expected in the foreign exchange regulations, corporate law and SEBI regulations which provide recognition to externalisation structures (especially those having no operations) and flexibility in their operations. The draft regulations, which may soon see light of the day, are discussed in this Part.



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FOUR PART SERIES

Part Four: What's in store for entities looking to externalise

1 Direct Overseas Listing

Hitherto, Indian securities could be listed on overseas bourses by way of depository receipts, popularly known as American Depository Receipts (ADR) and Global Depository Receipts (GDR). Consequent to SEBI's initiative of constituting a high-level committee in June 2018 and its report released in December 2018, the Government, for the very first time, took steps in the direction of allowing overseas listing of an Indian company. The SEBI report¹ suggests 10 major countries², based on their strong anti-money laundering laws, for considering listing of Indian companies.

Consequently, the Companies Act (Amendment) Act, 2020³, which was enacted on 28th September 2020, amended section 23 of the Companies Act, 2013, thus opening the route of direct overseas listing for public companies (listed or unlisted). Private companies may not be accorded this flexibility. While the Companies Act has been amended for granting permission for overseas listing, the framework and modalities for such listing is still awaited.

However, we are still far from this becoming a reality right now based on the recent reports⁴ which highlights tax related concerns bothering the government leading to delay in final announcement of this much awaited liberalization.

Similar clarity may emerge from the Income tax Department about the manner of taxation of such securities listed in foreign jurisdictions in the hands of the non-resident shareholders.

¹ https://www.sebi.gov.in/reports/reports/dec-2018/report-of-the-expert-committee-for-listing-of-equity-shares-of-companies-incorporated-in-india-on-foreign-stock-exchanges-and-of-companies-incorporated-outside-india-on-indian-stock-exchange_41219.html

² The United States of America, The United Kingdom, Switzerland, South Korea, Japan, Hongkong, Germany, France, China and Canada.

³ https://www.mca.gov.in/Ministry/pdf/AmendmentAct_29092020.pdf

⁴ <https://www.livemint.com/market/stock-market-news/indias-overseas-listing-rules-for-companies-delayed-due-to-tax-concerns-report-11629129453795.html>

2 ODI Regulations

The existing restrictions like obtaining prior approval of the RBI in case of round tripping issue is expected to be done away with as long as the structure does not result in tax avoidance⁵.

This is a welcome move since it recognizes the modern investment structures under externalization and SPACs which may involve remitting funds abroad to setup overseas entities which in turn will setup and invest in step down subsidiaries in India as well as in other countries. The RBI recognizes that not every transaction involving round tripping may be designed for tax evasion or money laundering, i.e., if a transaction is motivated by commercial reasons like access to overseas bourses, better opportunities to find investors etc., the transaction may be allowed.

⁵ Draft Foreign Exchange Management (Non-debt Instruments - Overseas Investment) Rules, 2021 (https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=52026)

3 SEBI Regulations

SPACs are also known as "blank check companies" which is - a development stage company that has no specific business plan or purpose or that its business plan is to engage in a merger or acquisition with an unidentified company.

The extant SEBI Regulations do not recognize SPACs as an entity eligible for listing. For the purpose of public listing, an Indian company must, inter alia, meet the tests of minimum net worth, minimum profits over a period of 3-5 years and a minimum value of tangible assets.

Reports suggest that SEBI is exploring a framework for SPACs in India⁶ which could address the impediments for listing of blank check companies in India. Indian stock markets are mature, have depth and are open to new avenues.

A dedicated framework for SPACs could go a long way in diverting domestic funds into emerging sectors with huge potential.

Further, they would also prevent SPACs from considering overseas listing in the absence of a dedicated framework in India.

⁶ <https://economictimes.indiatimes.com/markets/stocks/news/sebi-exploring-framework-for-spacs-in-india-says-chairman-tyagi/articleshow/84820599.cms?from=mdr>

4 Our Take

We are at an interesting point in time when individuals and SMEs are willing to take entrepreneurial risks, startups are flourishing and there are PE Funds or HNIs willing to invest in such startups. The future would matter for the SPACs to continue to list overseas. Further, all regulatory authorities issuing a consolidated policy for SPACs would be highly appreciated by the stakeholders. Needless to say, above all this, implementation in the right spirit will be a crucial aspect for its success.

With the success of many recent IPOs on the Indian bourses, it may be worthwhile for the startups to consider listing on Indian bourses as an alternative to externalisation.

While regulations in the externalisation sphere are still evolving, the regulations on domestic listing have matured over the years. Tax and regulatory certainty are some of the crucial factors which may determine the alternative chosen.

The Indian Government is rightly lending its ear to the investors and founders of startups. Time and again, the Government is issuing directives to promote investments in the startup sector.

Given the Government support to startups, it is only a matter of time before regulations for listing are made easy, with the necessary safeguards, to allow flexibility to startups to list in India or overseas or even externalise prior to listing.

