FOG OF OPACITY: DEMYSTIFYING SHELL COMPANIES LEGISLATION - A PRESCRIPTIVE FRAMEWORK FOR MITIGATING FINANCIAL IRREGULARITIES IN INDIA

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ABSTRACT

"'When scams occur in multiple branches of the same institution and yet no alarm is raised, it is a matter of grave concern.' - Arun Jaitley, Former Finance Minister of India"[3]

In the intricate web of corporate governance, legislative loopholes often serve as a catalyst for unscrupulous market players to further their interests and satiate their greed. The resultant operating efficiency may appear impressive and productive on the face of it but it conceals a more sinister truth. The very infamous Harshad Mehta scandal, which exposed glaring flaws in the stock market, led to a belated effort to fortify the exchange's stability.

Another grey area in corporate governance is the one of shell companies which are hollow entities devoid of substantial assets just like a shell. The ambiguity of this term stems from lack of a codified definition. The present research paper is divided into four segments. The first segment delves into the evolution of shell corporations and its impact on the enigmatic world. The second segment elucidates the recommendations of FATF, a globally recognized authority in combating white collar crimes. The third segment scrutinizes the shell corporation provisions under companies act and highlights the inaccuracies and lack of legislative framework. The fourth and final segment of the paper proposes corrective measures advocating the establishment of a robust framework to combat illicit activities associated with shell companies and further promoting transparency and accountability in the corporate landscape.

KEYWORDS

Shell companies, Section 248 - Companies Act, 2013, Registrar of Companies, Dormant Companies, White collar crime, Financial Action Task Force.

[3] 'Jaitley slams regulators over PNB fraud, says such cases affect ease of doing business' (Hindustan Times, 24 February 2018) < Jaitley slams regulators over PNB fraud, says such cases affect ease of doing business - Hindustan Times> accessed 19 January 2025.

INTRODUCTION

"Shell companies have proved to be at the heart of all corporate shenanigans involving round-tripping of funds and masking the identities of the real "puppet masters"[4]

The political and economic wings of the country breathed heavily during parliamentary proceedings in Sabhas, as did the National Stock Exchange, when the Hindenburg report alleged Adani's links to shell firms, with Madhabi Puri having an account in one of them.[5] Not for the first time, some promising names in the case of Shell Companies have come together; the world recalls the global uproar caused by the disclosure of the Panama Papers by the Panamanian firm Mossack Fonesca in 2016.[6] When a list of exposed figures includes King Salman,[7] Vladimir Putin's advisors,[8] the average person has a lot to worry about when it comes to the regulations and laws that regulate them.

The single-owner business model functioned well in antiquity, but with the Renaissance and Industrial Revolution, it failed to cater for commercial and professional needs. The dawn of more efficient means of communication and transportation accelerated the rise of trade and business, as did the necessity to be profitable. Thus emerged the "Corporate structure"[9] of business, wherein natural individuals and corporate entities were recognised as distinct entities.

Regardless, the Western pattern differed from India's. India's corporate history has featured courageous entrepreneurs who, under the guise of manipulating rules and regulations, have

[4]Van Der Does De Willebois,Emile Johannes Marie; Halter,Emily Marie; Harrison,Robert Anthony; Park,Ji Won; Sharman,Jason Campbell, 'The puppet masters : how the corrupt use legal structures to hide stolen assets and what to do about it (English). Stolen Asset Recovery (StAR) initiative Washington, DC: World Bank.' http://documents.worldbank.org/curated/en/784961468152973030/The-puppet-masters-how-the-corrupt-use-legal-structures-to-hide-stolen-assets-and-what-to-do-about-it.

[5] 'Adani-Hindenburg Saga: A chronology of how a US short-seller sent one of India's biggest conglomerates into turmoil'(The Economic Times, 11 August, 2024) < Adani-Hindenburg Saga: A chronology of how a US short-seller sent one of India's biggest conglomerates into turmoil> accessed 3 January 2025.

[6] Will Fitzgibbon & Martha M. Hamilton, 'Law Firm's Files Include Dozens of Companies and People Blacklisted by U.S. Authorities' (International Consortium of Investigative Journalists, 4 April, 2016) < Law Firm's Files Include Dozens of Companies and People Blacklisted by U.S. Authorities - ICIJ> accessed 3 January 2025.

[7] MEE Staff, 'Secret dealings of Middle East leaders exposed by Panama Papers leak' (Middle East Eye, 4 April, 2016) < Secret dealings of Middle East leaders exposed by Panama Papers leak | Middle East Eye> accessed 3 January 2025.

[8] Marina Walker Guevara, 'ICIJ releases Panama Papers offshore company data' (International Consortium of Investigative Journalists, 9 May, 2016) < ICIJ releases Panama Papers offshore company data - ICIJ> accessed 3 January 2025.

[9] Dharmvir Singh, 'Incorporating with Fraudulent Intentions: A Study of Various Differentiating Attributes of Shell Companies in India' (2010) 17 J Fin Crime 459.

ventured beyond normal business norms and, in some cases, have formed organisations with fraudulent objectives.[10] One such phenomena is the presence of Shell Corporations.

RESEARCH METHODOLOGY

This study will employ a **doctrinal research methodology** to examine the problems with shell companies' legislation in India. The research will rely on secondary data sources, including legislative materials, judicial decisions, research papers, articles, and reports from regulatory bodies. A comparative analysis will be undertaken to examine the legislative and regulatory frameworks governing shell companies in India and other jurisdictions. The study will identify problems with shell companies' legislation in India, including loopholes, ambiguities, and enforcement challenges, and propose recommendations and suggestions for reform.

EXISTING LANDSCAPE OF SHELL COMPANIES

A shell company is defined as "a registrant with no or minimal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets."[11] Shell Companies are "legal entities" having the power to maintain bank accounts, own and sell property and assets because they are typically formed as Limited Liability Partnerships, Limited Liability Companies, private foundations, and/or Asset Protection Funds.[12] As a result, there is no specific definition of Shell Companies under Indian statutes, which is a significant gap that has an economic impact on the country's balance sheets.[13]

The Organisation for Economic Cooperation and Development (OCED) defines shell companies as *"a company that is formally registered, incorporated, or otherwise legally organised in an economy but does not conduct any operations in that economy other than in a pass-through capacity."* Shells are typically conduits or holding companies that fall under the category of Special Purpose Entities.[14] Shell corporations appear to serve three purposes, which

[10] Dharmvir Singh, 'Incorporating with Fraudulent Intentions: A Study of Various Differentiating Attributes of Shell Companies in India' (2010) 17 J Fin Crime 459.
[11] Securities Act of 1933, 15 U.S.C. 77a et seq.
[12] Michael Findley, Daniel Nielson, and Jason Sharman, 'Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies' (2012) Centre for Governance and Public Policy 1, 7.
[13] Raj Aryan & Dharna Rajpal, 'Shell Companies: Illegality in Functioning & Regulatory (The Daily Guardian, 30 September, 2020) < Shell companies: Illegality in functioning & regulatory framework - The Daily Guardian> accessed 4 January 2025.
[14] Assam Company India Ltd. and Anr v. The Union of India, WP (C) 2572/2018.

are why the majority of them are formed under the corporate veil: ***(i)*** **tax evasion**, ***(ii)*** **identity concealment**, and ***(iii)*** **money laundering**, a worldwide known crime.[15]

Apart from all ill-gotten gains, shell companies are used for legitimate purposes such as a) maintaining anonymity, b) staging hostile takeovers, c) going public with a reverse merger, d) concealing dealings between two companies,[16] and to preserve business optics, Adidas formed a company called 'Adidas Originals' to enter the fashion apparel market, which was different from their identity of sports apparel.[17]

We have observed tax havens used as a conduit for foreign earnings both in India and around the world. The loophole has had such a ripple effect that US multinational corporations' foreign subsidiaries' accumulated profits,[18] which have yet to be repatriated back home, are estimated to be worth between $2.1 and $3 trillion.[19] According to OCED data, Shell Companies account for more than 80% of all foreign direct investment in Luxembourg and the Netherlands.[20] Mauritius looks to account for almost one-third of FDI into India due to a tax compact between the two countries. When the scope of commerce and the quantity involved are vast, there is an inevitable question about the lack of statutory provision.

Cases affecting Shell Companies are handled in accordance with the rules of the **Companies Act 2013,[21] the Prevention of Money Laundering Act,[22] and the Income Tax Act;**[23] however, the lack of a specific definition makes it difficult for the authorities to adjudicate a case. The provision of Dormant Companies in the Companies Act comes closest to the notion of Shell Companies**,**[24]yet they are different.

[15] 'FATF Annual Report 2020-2021' < FATF Annual Report 2020-2021> accessed 19 January 2025.
[16] 'Shell Company: Everything You Need to Know' (Upcounsel, June 20,2020) < https://www.upcounsel.com/shell-corporation> accessed 19 January, 2025.
[17] Riya Gupta & Divita Vashisht, 'Disrobing Shell Companies Combating Maliciousness through Corporate Governance' (2023) 6 Int'l JL Mgmt & Human 629.
[18] Contractor FJ, ' Tax Avoidance by Multinational Companies: Methods, Policies, and Ethics' (2016) 16 AIB Insights.
[19] Tax Avoidance by Multinational Companies: Methods, Policies, and Ethics (Updated) – GlobalBusiness . blog – Education, Commentaries, & News from Economic & Cultural Perspectives.
[20] OECD (2015, February). How multinational enterprises channel investments through multiple countries. Retrieved from https://www.oecd.org/daf/inv/How-MNEs-channelinvestments.pdf.
[21] The Companies Act, 2013.
[22] The Prevention of Money Laundering Act, 2002.
[23] The Income Tax Act, 1961.
[24] The Companies Act, 2013, s 455.

LEGAL FRAMEWORK GOVERNING SHELL COMPANIES IN INDIA

In a blaze of righteous zeal to stamp out black money soon after its misadventure with demonetisation and the natives seeking government response to Operating Shell Companies, the Narendra Modi government in India launched a campaign in 2018 to ferret out the country's so-called shell companies that served as conduits for dodgy financial transactions between companies. Even if attempts were commendable, the distinction between **Shell Companies** and **Dormant Companies** remained murky.

Indian government since almost a decade is trying to grapple with the complexities of the phenomenon of shell companies therefore it has become more urgent than ever in the developing Indian economy to combat this challenge and comprehend this nuanced understanding of shell companies' phenomenon.

The present analysis by the authors not only delve into the intricacies of this phenomenon while highlighting various regulatory loopholes but also touch upon the potential solutions to this unsolved problem.

GOVERNMENT STRIKING OFF SHELL COMPANIES:[25]

The Indian Government's crusade against shell corporations has been in headlines since 2021 where the government struck off 2,38,223 companies between 2018-2021.[26] Well this move of the government is a bold and appreciable step to purge the corporate sector of the rogue entities but it seems a little difficult to not raise an eyebrow at the irony of it.

Former Union Minister of State for Corporate Affairs Shri Rao Inderjit Singh acknowledged that there's no definition of shell companies in Indian law, [27] and even the court in the case of **Assam Company India Ltd. vs The Union of India**[28] was of the same stance then what criteria did they use to identify these companies and then further strike them off? It seems like they are saying. "We know it when we see it."

[25] PIB Delhi, 'Government identified 2,38,223 companies as shell companies between 2018-2021
[26] PIB Delhi, 'Government identified 2,38,223 companies as shell companies between 2018-2021
'(Ministry of Corporate Affairs, 27 July, 2021) <Press Release: Press Information Bureau> accessed 19 January 2025.
[27] Ibid
[28] Assam Company India Ltd v. The Union of India, WP(C) No. 2572 of 2018.

The ministry cited section 248(1) of the companies act, 2013[29] as the basis for their actions of striking off the companies.[30]

To gain a deeper understanding of this provision, let's examine this section in detail:

SECTION 248: POWER OF THE REGISTRAR TO REMOVE THE NAME OF THE COMPANY FROM THE REGISTER OF COMPANIES;

"This section gives the power to the registrar to remove the name of the company from the registrar of the companies if he has reasonable cause to believe that:

(a) Company has not commenced its business operations within a year of its establishment or,

(b) Company has failed to carry business for a period of two years immediately prior to the current financial year and furthermore has not made any application within that period for obtaining the status of a dormant company under companies act."[31]

According to this section the ROC can strike off the name of a company only under these two circumstances but it is pertinent to note that almost every shell company does not trigger these conditions mentioned based on which they are struck off. [32] There are other factors that influence the working of a shell corporation which this particular section has failed to incorporate under its ambit.

According to the author's analysis the above action of the government of striking off the shell companies is based on 2 assumptions:

1. Companies that have not carried on any business operations in the preceding 2 years are definitely shell companies which are doing illicit activities due to non-commencement of their business.
2. And secondly to determine whether the company has carried on any business operations or not, the government has taken the criteria of filing the report of financial transactions of that accounting year.

Both of these assumptions are flawed.

[29] The Companies Act, 2013, § 248(1), No. 18, Acts of Parliament (India).
[30] PIB Delhi, 'More than 3.82 lakh companies struck off till financial year 2020-21 in Special Drives taken by Registrar of Companies' (Ministry of Corporate Affairs, 15 March, 2022) < Press Release:Press Information Bureau> accessed 19 January 2025.
[31] The Companies Act, 2013, § 248(1), No. 18, Acts of Parliament (India).
[32] Gupta, Riya, & Vashisht, Divita. (2023). Disrobing Shell Companies Combating Maliciousness through Corporate Governance. International Journal of Law Management & Humanities, 6, 629-640.

Firstly, if a company has not carried on a business for 2 years or if it hasn't commenced its business in the first year, then it can have multiple reasons like:

- The company is waiting for the market conditions to improve
- The company is re-evaluating its business strategies
- Company is undergoing infrastructural changes or restructuring like mergers, acquisitions.
- Companies whose business is seasonal may not operate in off seasons like tourism and agriculture.

Therefore, striking off companies just on this basis, leaves us with a possibility that the government is intentionally or unintentionally targeting legitimate companies that are not dormant.

The government can take a more holistic approach and in order to better distinguish between legitimate businesses and shell businesses, take additional factors into consideration while striking off a company. This can be better achieved by defining the scope and ambit of shell companies.

Secondly, the government has also considered the aspect of financial transactions while identifying the shell companies. However, it is pertinent to note that the phrase "**operational business" and "Non-operational business" has also not been defined** under the companies act, 2013 therefore, the interpretations for these 2 phrases have led to inconsistencies in its application. The ROC while striking off the companies, consider them to be non-operational if they have not filed their financial statements.[33] Whereas the National company law tribunal and the National Company Law Appellate Tribunal have taken a more nuanced approach on this matter. They have clearly stated that if a company fails to file its financial statement, irrespective of being operational or non-operational, it's striking off cannot be justified solely on this ground.[34] The author will revisit this aspect again in the analysis of the paper.

[33] Rupa Veena S, Shariba Tasneem, 'Strike-off by RoC under Companies Act 2013: An Action Too Harsh on Companies?' (The Indian Review of Commercial and Corporate Law, 7 October, 2022) < Strike-off by RoC under Companies Act 2013: An Action Too Harsh on Companies?> accessed 19 January 2025.

[34] Sanmati Agrizone Pvt. Ltd. Vs. The Registrar of Companies (2021) ibclaw.in 794 NCLT.

VALIDITY OF REGISTRAR OF COMPANIES ACTION DUE TO UNCLEAR DISTINCTION BETWEEN SHELL COMPANIES AND INACTIVE/DORMANT COMPANIES.

When we talk about the position of ROC, the companies act legislation has vested in him some key powers for regulating the companies and ensuring their compliance with the provisions of the act. Section 248 grants one such power to him of removing striking off the names of the companies from the Register. But as we have seen above, the recent actions of the ROC in the last couple of years have raised questions on the validity and legality of such actions. This question was raised due to the bafflement in determining the point of difference between shell companies and inactive companies.

Shell companies are usually termed as ones which have no significant assets or operations and often used for illicit purposes of money laundering and tax evasion etc. whereas as defined under explanation 1 of section 455 of companies act, dormant or inactive companies are the ones which have either ceased to carry their business or has not made any significant accounting transaction during the last two financial years or has not filed financial statements and annual returns during the last two financial years.[35]

The ROC's action of striking off the companies assumed that these companies are inactive companies.[36] But this assumption is not necessarily correct. Shell companies under the Indian Legislation are legal entities[37] and therefore there is a logical possibility that shell companies may be active companies but want to remain unlinked with their original brand like **Adidas Originals**[38] and there is also a possibility that the inactive companies may be companies that have temporarily ceased to carry on business.[39]

Another criterion used by ROCs for determining these companies as inactive companies is non filing of the company's financial transactions. Section 248 nowhere mentions explicitly "Non Filing of financial transactions" as a ground for striking off the companies from the register.

[35] The Companies Act, 2013, § 455, No. 18, Acts of Parliament (India).
[36] Gupta, Riya, & Vashisht, Divita. (2023). Disrobing Shell Companies Combating Maliciousness through Corporate Governance. International Journal of Law Management & Humanities, 6, 629-640.
[37] Harshita Yadav, An Analysis of Recent Corporate Frauds in India and USA and Their Nexus with Corporate Governance, 5 INT'L J.L. MGMT. & HUMAN. 337 (2022).
[38] Riya Gupta & Divita Vashisht, 'Disrobing Shell Companies Combating Maliciousness through Corporate Governance' (2023) 6 Int'l JL Mgmt & Human 629.
[39] Paul Dixon, 'What Is a Shell Company in Money Laundering? A Key Tool for Criminals' (Sanctions.io, 9 May, 2023) < What Is a Shell Company in Money Laundering? A Key Tool for Criminals | sanctions.io> accessed 18 January 2025.

But this term is used under section 455 of the act.[40] Whereas it is pertinent to note that the term is used there in relation to dormancy of a company and not striking off.

As per section 455, if a company has not filed the financial transactions, then the first course of action to be taken against it is dormancy[41] and not striking off. As per sec 455, if a company fails to file the financial transactions, then the ROC serves it a notice and upon no justifiable cause, enters its name in the register of dormant companies.

The companies which have been struck off recently have also not been done by the procedure laid down under Company rules 2016.[42] Let us look at the steps involved in striking off companies.

- **Rule 3(2):**
  - Sending a notice to of the proposed action to the company and the directors by the ROC along with the reasons for the same in STK-1 form. This notice is to be sent by the registered post or speed post.
  - Give opportunity to the company for making its representation in 30 days from the date of notice as it is presumed that this notice is not a strike off notice but rather the one which deems the company inoperative.
- **Rule 7:**
  - Issue a pre-strike notice under 248(1) in STK-5 Form to the company and its directors.
  - Publish the issued notice in the official gazette **248(4).**
  - This notice shall also be published in the newspapers state wise.
  - This notice is also put up on the MCA Portal.
  - Provide 30-day period for receiving objections from the regulatory authorities such as tax authorities.
- **Rule 9:**
  - Finally issue a strike off notice under STK-7 Form after the expiry of 30 days period.
  - Publish the same in the official gazette and website of MCA.[43]

Once this notice is published and released, the company is dissolved and has no more legal foundation. But the various strike offs which have been taking place were neither published in

[40] Id at 12.
[41] Id at 12
[42] The Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016.
[43] Mayashree Acharya, 'Application for Strike Off of a Company' (Cleartax, 16 June, 2024) < Application For Strike Off Of A Company> accessed 19 January 2025.

any newspaper nor there was any information about them in any official gazette.[44] This again raises questions about the legitimacy and validity of the actions by ROC.

STANCE OF JUDICIARY:

Judiciary in **Basanti Cotton Mills vs The registrar of companies** rules out of how important it is to follow the strike off procedure under section 560[45] and 248 of the companies act. In case if there is any procedural irregularity under section 560 then that decision of the ROC would not be legitimate and would render the strike off as void.[46] Similarly in **Poly Auto Systems Pvt. Ltd. Vs ROC Delhi** the NCLT also emphasised on the importance of adherence to the procedural obligations by the ROC before passing the final order of a strike off.[47]

Despite these judicial rulings, the procedure was not followed leading to arbitrary strike off of the companies. The main issue behind this negligence is **lack of statutory clarification** for concept of shell companies. It becomes challenging for the ROC for determining a company as a shell companies and as a result his discretionary power often lacks justification. Due to lack of clarity, it is difficult to hold the ROC accountable also because for the court also it would be challenging to determine whether proper procedure has been followed or not as there are no clear guidelines as to under what circumstances the strike off is to be done.

Dormancy is a less severe measure which leaves a scope for the company to revive itself and continue its operations whereas striking off is an extreme and drastic step which only ends in a company's dissolution. Therefore, it is extremely important to determine the validity of the actions of a ROC and make sure he has followed all the proper procedures and protocols before striking off the companies solely on the basis of non filling. Therefore, it can be concluded from the above logical flow of arguments that striking off companies solely on the basis of non-filing is **ultra vires** of companies act.

[44] Snehil, Nikita. (2018). Strengthening corporate governance by 'operation clean money' in corporate sector ministry's move to checkmate black money. Journal on Governance, 2(3), 11-27.
[45] The Companies Act, 2013, § 560, No. 18, Acts of Parliament (India).
[46] Basanti Cotton Mills v. The Registrar of Companies, (1998) CP. No 432 of 2010.
[47] Nikita Snehil, ' Slaying the slain: the law about strike- off of companies' (Vinod Kothari Consultants, 19 September, 2017) < Slaying the slain: the law about strike-off of companies – Vinod Kothari Consultants> accessed 18 January 2025.

INTERNATIONAL BEST PRACTICES TO COMBAT ILLICIT SHELL ACTIVITIES

I. The case of United States of America

The requirements for transparency of US-registered companies were significantly altered by the **Corporate Transparency Act ("CTA"),** which took effect on January 1, 2021.[48] *Currently, anonymous shell companies are unable to hide their owners' identities.* Restricting people's ability to conceal their activities under anonymous shell companies is the aim of CTA. By taking this action, CTA will contribute to the eradication of the idea that the United States is a "safe haven" and to the state's anonymous shell company activities.[49]

CTA will probably deter the majority of inconsiderate usage of shell corporations, but it won't stop well-funded actors with the resources to undermine it. *Therefore, Congress should amend the CTA to eliminate exploitable weaknesses and make it extremely difficult for powerful actors to subvert its objectives.*[50]

II. The case of United Kingdom

Corporate Entities were required to give the **true identity** of shell company owners upon request from authorised law enforcement in the British Overseas Territories and Crown Dependencies. The UK requires governments to make the identities of shell company owners **publicly available** on December 31, 2020. It was the most recent effort to stop tax evasion and rampant corruption in British properties abroad.[51]

III. Financial Transparency Coalition and FATF

The Financial Transparency Coalition, *which is formed with a framework of a mutual working of government and civil societies from every corner of the world to put a pause on illegal financial remittance*.[52] The organisation also highlighted standardization as a foremost loophole to regulate financial flow and exacerbates this globally acclaimed issue. Due to lack

[48] Robert Appleton, Olshan, Frome & Wolosky LLP, 'The End of the Anonymous Shell Company in the United States' (Harvard Law School Forum on Corporate Governance, 4 February, 2021) < The End of the Anonymous Shell Company in the United States> accessed 19 January 2025.
[49] Ibid
[50] Real Estate Industry May be Subject to Significant New Reporting Burdens in 2021: Corporate Transparency Act Passes Congress.
[51] 'Secret owners of 'shell' companies to be made public' (BBC News, 31 October, 2013) < Secret owners of 'shell' companies to be made public - BBC News> accessed 19 January 2025.
[52] Financial Transparency Coalition, https://financialtransparency.org/about/.

of standardisation, a country's robust legal and regulatory system can simply move the issue to another with less stringent standards.

Regardless, the recommendations put forth by the FATF which acts as a universal string attached to comply for by every country with regards to anti money laundering (AML) measures serves the purpose to some great extent. The Prevention of Money Laundering Act[53], introduced in response to compliance with FATF's AML measures wilfully serve the purpose in Indian Context.

RECOMMENDATIONS- FATF

Recommendation-10: Customer Due Diligence[54]

Lawmakers contend that financial institutions should not protect accounts with clearly bogus identities or those that are indistinguishable. Every nation will formulate its legislation appropriately, but the following actions would be most beneficial:

1. Identification of customer is verified by reliable documents;[55]
2. Identification of beneficial owner by taking reasonable steps;[56]
3. Getting hold of information shall be in sync with intended nature of business relationship;[57]
4. Consistent scrutiny of transactions and conducting ongoing due diligence.[58]

Recommendation -24&25: Transparency and Beneficial Ownership of Legal Persons[59]

Countries ought to ensure sure that, via a register of beneficial ownership or an alternative approach, competent authorities can rapidly and efficiently obtain sufficient, accurate, and current information on the beneficial ownership and control of legal persons.

Recommendation- 30&31: Responsibilities and Powers of Law Enforcement and Investigative Authorities[60]

FATF recommendation includes having a law enforcement authority having a mechanism for money laundering and terror financing investigations without overstepping the National AML

[53] The Prevention of Money Laundering Act, 2002.
[54] INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION' < The FATF Recommendations> accessed 19 January 2025.
[55] Ibid
[56] Ibid
[57] Ibid
[58] Ibid
[59] Ibid
[60] Ibid

Policies. There shall exists a pro-active parallel financial investigation when pursuing money laundering, terror financing.

Countries should ensure that competent authorities have responsibility for expeditiously identifying, tracing and initiating actions to freeze and seize criminal property and property of corresponding value.

POLICY RECOMMENDATIONS: THE WAY FORWARD

The shell companies menace is a persistent challenge for the Indian Economy which has been growing ever since. Despite efforts by the MCA to curb this issue, the lack of clarity between shell and dormant companies due to lack of legislation has led to inconsistent and ambiguous decisions of the law by the ROC. The action of striking off the companies is the power under section 248 but the basis of the strike off which is non filing of financial statements is the criteria given under section 455 for dormant companies. Thus, cause of action is in one section whereas the consequence is in another.

The authors would like to propose the following suggestions and recommendations that would provide a robust framework for regulation of shell companies pan India.

CLEAR DEFINITION:

For resolving this conflict and confusion, the government needs to provide a clear definition and make enabling provisions for the ROC that facilitates his actions. These guidelines and provisions will help make the actions of the ROC fair and transparent and as per the provisions of the law.[61] Until this is done, the actions of the ROC will continue being challenged and due to this very reason, the companies will continue facing uncertainty and unfair treatment.

The government initiated the process of framing the definition in 2018 and sought suggestions for the same from various ministries including RBI, SEBI etc.[62] Some key institutions also provided suggestive definitions and as per the then reports govt was planning to soon come out with the definition.[63] However, due to COVID 19 pandemic, this process of govt was put on

[61] 'Parliamentary panel asks government to define 'shell companies' in Companies Act' (The Economic Times, 11 March, 2018) < Black Money: Parliamentary panel asks government to define 'shell companies' in Companies Act - The Economic Times> accessed 19 January 2025.
[62] 'Govt, regulators mull challenge-proof definition for shell companies' (The Economic Times, 13 May, 2018) < shell companies: Govt, regulators mull challenge-proof definition for shell companies - The Economic Times> accessed 19 January 2025.
[63] 'Govt to soon come out with definition for shell companies' (Mint, 1 July, 2018) < Govt to soon come out with definition for shell companies> accessed 19 January 2025).

halt and since then there has been no update on the same. This inaction of the government is a significant threat to the country therefore it is the need of the hour to restore the confidence in the regulatory framework and make the law for the same.

ESTABLISH CRITERIA FOR DIFFERENTIATION

A framework should be developed that clearly differentiates genuine shell companies which are legal from the ones which are used exclusively for illicit purposes.

The criteria can include the following indicators:

- Business purpose and activity of the company
- Ownership structure and control of the company
- Financial transactions and reporting procedure of the company
- Compliance with regulatory requirements and consequences of non-compliance.

INTEGRATED FRAMEWORK

The law should be simplified and integrated into one compact framework that facilitates corporate governance. This will eliminate the need of various disconnected laws related to shell companies like Companies Act, 2013, Prevention of Money Laundering Act, 2002, Income Tax Act, 1961 etc.

BENEFICIAL OWNERSHIP

Beneficial ownership, originally prevalent in United Kingdom is a concept of disclosure that refers to transparency of ultimate ownership and control of a company. This step will help in preventing anonymous ownership and in turn detect and deter illegal activities which will enhance transparency and accountability. This beneficial ownership can be achieved through:

- Mandatory disclosure where the companies including shell must disclose their director details and the owner of the company.
- A separate register at a central level should be maintained by the government to collect and preserve the beneficial ownership information.[64]

[64] 'The EITI Standard, EITI International Secretariat' < EITI Standard explainer - June 2024.pdf> accessed 19 January 2025.

- This ownership information should be made available to public as per the government rules and guidelines.[65]

STRENGTHEN SFIO:

SFIO is the serious fraud Investigation Officer which is a specialist apex body investigating serious corporate frauds. Although it has been devoured with some authority but he needs to be strengthened more for him to investigate and prosecute shell companies effectively[66].

- Empower SFIO for the power of search and seizure along with freezing the assets and bank accounts so that relevant evidence is not destructed.
- He should be given enough authority to investigate corporate crimes and fraud under other legislative laws like BNS and Prevention of Corruption Act.
- His team should contain individualised experts from the field of forensic accounting, corporate regulation, and information technology.

ADOPT KYC NORMS

For preventing frauds through shell companies, another step which could be taken is adopting KYC Norms. As we know companies under Indian Legislation are juristic persons which makes them the customers of the government and other regulators in the nation. Therefore, KYC norms can be helpful deterrer in preventing frauds. With the help of differing attributes of a shell company, government can devise a system which will auto trigger if there is any deviation from the standard attributes of a shell company. This is a practical point as this is possible to implement in an unintrusive manner based on information available in the public domain. If it triggers the system then a deep investigation can be conducted further. This will help the regulators to understand the companies better (customers) and identify shell companies.[67]

[65] Prime Minister's Office, 10 Downing Street and The Rt Hon Lord Cameron, 'G8 action plan principles to prevent the misuse of companies and legal arrangements' (Government.UK, 18 June, 2023) < G8 action plan principles to prevent the misuse of companies and legal arrangements - GOV.UK> accessed 19 January 2025.
[66] *Incorporating with Fraudulent Intentions : A study of various differentiating attributes of Shell companies in India*. (n.d.). https://www.researchgate.net/publication/239781518_Incorporating_with_fraudulent_intentions_A_study_of_various_differentiating_attributes_of_shell_companies_in_India
[67] Ibid

CONCLUSION

In the realm of corporate Finance, a specific phenomenon which emerged recently, shrouded in "**Fog of Opacity"** has been shed light upon in this paper by the authors. Initially the concept of shell companies was in a state of temporary unclarity, akin to natural fog that obscures vision. This was mainly due to scarcity of such companies and the limited cases of their misuse. However, with the advent of technology and growth of man kind towards more capitalistic economy, shell corporations were widely formed which gave rise to a number of cases of money laundering, tax evasion and other financial malfeasance. Basically, the fog has lifted, revealing a more sinister veil of opacity.

This deliberate and intentional human made unclarity is perpetuated despite the growing awareness and instances of shell companies' potential abuse. And the absence of clear definition has enabled the continued exploitation of these corporations which further undermines the integrity of our financial system.

The present research paper executed comprehensive analysis of the difficulties and problems related to shell corporations doing business in India as well as the critical requirement for a strong regulatory framework that would eradicate the illicit activity. After comprehending the premise of shell corporations, the authors have further explored worldwide viewpoint and the international framework that aims to address their operations on a larger scale.

Focus of this research paper centred around interpreting the statutory provisions of Company Law concerned with Shell Companies, i.e. Section 248 and 455 and unravelled the loopholes in it. The authors are of the view that this issue needs to be addressed to great length considering the quantum of ambiguity it carries with and re-iterated the need for a clear definition in the statutory books.

A thorough process for distinguishing between legitimate shell companies and those used for money laundering needs to be implemented. And thus, the authors have proposed a comprehensive and intact network for corporate governance so that the need of various disintegrated laws is removed along with adopting the KYC functionary which has been a success in the banking sector.

A more open, accountable, and reliable business environment can be championed in India by tightening the regulatory framework and remaining watchful in recognising and mitigating risks. Upholding the nation's reputation and reaffirming its dedication to moral and legal business practices are two goals of the joint effort to stop illegal activity linked to shell

corporations. It is essential that India **adopt these actions as we look to the future to guarantee the health of its financial systems and the prosperity of its people**.

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